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Private Company Acquisitions: A Mock Negotiation[1]

Panelists:

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Panel Chair, Moderator, and Counsel for Buyer;

Richard De Rose,[3]
Investment Banker;

Frances Murphy,[4]
European Counsel;

Michael L. Schler,[5]
Tax Counsel;

H. Lawrence Tafe III,[6]
Counsel for Target; and

Donald J. Wolfe, Jr.,[7]
Delaware Counsel

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1. An edited transcript of a panel presentation given in New York City on October 14, 2011, as part of the 8th Annual Institute on Corporate, Securities, and Related Aspects of Mergers and Acquisitions.

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I. INTRODUCTION

BYRON EGAN: (Moderator)

We are going to frame our discussion around a hypothetical fact situation. The buyer is an acquisition entity (***"Buyer"***) organized by a Texas private equity financial buyer. The target corporation is a Delaware corporation (***"Target"***) headquartered in Manhattan and owned by an extended and disjointed family (now approximately 30 stockholders). Target manufactures equipment at an old facility, which it leases in Brooklyn. The term sheet that the parties initially discussed, without the benefit of counsel, contemplated a negotiated sale for cash of all of the stock of Target to Buyer.

My name is Byron Egan, and I am with the law firm of Jackson Walker L.L.P. in Dallas. I will be representing Buyer in this negotiation as well as chairing this session. Target will be represented by H. Lawrence ("Larry") Tafe III of the law firm of Day Pitney LLP in Boston. Michael Schler, of the law firm of Cravath, Swaine & Moore LLP in New York, will be the tax advisor and will help Larry understand the tax consequences of the transaction. Donald ("Don") Wolfe, of the law firm of Potter Anderson & Corroon LLP in Wilmington, will play the role of the Delaware lawyer and will explain various Delaware issues involved in the transaction. Richard ("Dick") De Rose, of the investment banking firm of Houlihan Lokey Howard & Zukin in New York, will explain this proposed transaction from a financial perspective. Frances Murphy, of the law firm of Slaughter and May in London, will explain to us how the deal would be different if it were done in Europe.

Now, as often happens, Buyer has looked at the term sheet with the benefit of counsel and has realized that the transaction, as set forth in that term sheet, is problematic from Buyer's perspective. Based on my recommendations, Buyer is going to propose that we restructure this transaction from a stock sale to a sale of assets, or perhaps some combination of both, and is going to submit its form of asset purchase agreement (the ***"Proposed Agreement"***).[8]

II. CHOICE OF STRUCTURE: STOCK PURCHASE VS. ASSET PURCHASE

RICHARD De ROSE: (Investment Banker)	Byron, why at this stage are you proposing to change the form of the transaction from a stock purchase to an asset purchase?
BYRON EGAN: (Counsel for Buyer)	Normally, a buyer is going to seek to buy assets rather than stock for the simple reason that when you buy stock, you inherit the seller's accrued liabilities plus its contingent and other liabilities, even undisclosed liabilities. This is an inherent risk in any purchase of stock that leads the buyer to prefer to buy assets unless tax costs, regulatory issues,

8. *See* Byron F. Egan, *Acquisition Agreement Issues*, *in* 8th Annual Institute on Corporate, Securities and Related Aspects of Mergers and Acquisitions, New York, N.Y. (Oct. 14, 2011), at 28-298 [hereinafter *Acquisition Agreement*], *available at* http://images.jw.com/com/publications/1662.pdf.

or other considerations dictate otherwise. Further, in the course of Buyer's due diligence in this transaction, three problems that are specific to this deal have surfaced:

FIRST, the hypothetical fact pattern assumes that Target's stock is owned by a dysfunctional family that now numbers approximately 30 shareholders. There is no way that Buyer is going to be able to get all 30 shareholders to sign the same stock purchase agreement. Thus, if the transaction were structured as a negotiated stock purchase, Buyer would run the risk of being left with minority shareholders whose interests it would have to consider and to whom it might owe fiduciary duties.[9] In addition to not wanting to deal with minority shareholders, Buyer as the controlling shareholder does not want to owe any fiduciary duties to the minority shareholders,[10] and the people that Buyer wants to put on the board of directors (the ***"Board"***) of the acquiring entity certainly do not want to owe any duties to any minority shareholders. Further, Buyer is going to need to finance this transaction. Its lenders are going to require that Buyer pledge all of the assets of the purchased enterprise to secure the purchase money loan. If Buyer leaves a minority interest, Buyer may have fiduciary duty of loyalty issues in pledging Target's assets to secure Buyer's purchase money debt.[11]

SECOND, there are the environmental issues. If Buyer became the holder of the lease and the operator of the facility, Buyer could have state

9. *See* Byron F. Egan, *How Recent Fiduciary Cases Affect Advice to Directors and Officers and Delaware and Texas Corporations*, *in* 34th Annual Conference on Securities Regulation and Business Law, Dallas, Tex. (Feb. 10, 2012), at 11-38 [hereinafter *Fiduciary Duty Cases*], *available at* http://images.jw.com/com/publications/1712.pdf.

10. *See id.*

11. *See id* at 11-13.

and federal environmental liability exposure and would prefer to avoid that risk.[12] Since Buyer will not really need the leased facility post-acquisition, Buyer would prefer to buy the intellectual property and certain other assets of Target and leave the leased facility with Target.

THIRD, as Buyer has done its due diligence, Buyer has found certain sloppiness in Target's operations, and believes that there is a substantial risk that contingent liabilities and other problems are going to surface as it gets further into the due diligence process. Buyer wishes to eliminate its exposure to those potential liabilities by leaving them with Target.

Buyer can solve these problems if it leaves Target with the lease and the environmental liabilities. Buyer proposes to take the equipment and the intellectual property, including the patents, copyrights, and license agreements. Then, under the Delaware General Corporation Law (the ***"DGCL"***), a majority stockholder vote (assuming a stockholder vote was required) could approve the asset sale and there would be no dissenter's rights.[13] So we regard an asset purchase as a very simple transaction, and think that is the appropriate structure for this acquisition.

RICHARD De ROSE: (Investment Banker) So that sounds pretty good from Buyer's perspective. Larry, what's your preliminary reaction to this proposal?

12. *See* Byron F. Egan, *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 PENN ST. L. REV. 913, 945-47 (2012).

13. According to DGCL § 271, a corporation may sell all or substantially all of its assets upon such terms as its board of directors deems to be in the best interests of the corporation when authorized by the holders of not less than a majority of the corporation's outstanding voting shares. *See* DEL. CODE ANN. tit. 8 § 271 (2011); *id.* § 262.

LARRY TAFE: (Counsel for Target)

The problem is it just isn't the deal we made. I want to be sure that when all the dust settles, we have the same deal that we had on the term sheet in substance, and I do not think this proposal is going to get that here.

I would like to respond briefly to the three points Byron makes. He doesn't think we can get 100% of the stockholders to sign a stock purchase agreement. While this family is disjointed and dysfunctional, as Byron has said, it is not stupid. If this is a good deal, a majority can agree to sell their stock; and then Buyer can have a merger to get the remaining shares and avoid being burdened with minority shareholders.

As far as the environmental issues are concerned, Target is for sale as a company in the whole, not in pieces, and the costs of environmental claims can be addressed through indemnification.

The differences between the tax consequences of an asset transaction and a stock deal can be substantial, and Target needs advice from its tax advisor as to the tax consequences of an asset sale versus a stock sale. I also need some advice from the investment bankers to compare the value of what we are being asked to take now compared to what the term sheet contemplated. Finally, I need Don Wolfe to tell me something about the Delaware law consequences of an asset deal, particularly the stockholder approval requirements.

RICHARD De ROSE: (Investment Banker)

From an investment banker's perspective, divestitures (which are essentially private company transactions) actually constitute about a third of overall M&A activity in both good and bad economic conditions. Last year, in the U.S., divestitures aggregated about $280 billion dollars, which was roughly 34% of activity by value and about 31% by number. Similarly in Europe, that activity was about $236 billion, which represented about 40% in value and about 32% in the number of transactions.

Divestitures have some interesting issues associated with them. The first is really defining the business that is being sold and the assets that go with that business. That is less of an issue in this case because we are dealing with a standalone company; however, many private company deals are divestitures of divisions or newly created subsidiaries, where the issue of defining the business is more important.[14] The other issue associated with a divestiture is that once you have defined the business, you have to assess the ability of that business to operate on a standalone basis.

Advance planning is important because any surprises that show up, especially in the context of an auction, are going to have the effect of slowing down the process. Surprises can undermine the positioning of the business, and ultimately may lessen the seller's negotiating leverage.

Shared assets can be a big issue.[15] The buyer will want certainty that it is getting all the assets that it needs to operate the purchased business. On the other hand, the seller is going to want to try to limit the assets to be transferred to those that are used either "exclusively" or "primarily" in the operation of the business. Sometimes this is simple. Often, it gets very complicated because you may have material assets, things like a factory or

14. *See Acquisition Agreement, supra* note 8, app. D at 1-2.
15. *See id.* at 5-8.

intellectual property, which are used both by the business that is being sold and by the other businesses that are going to remain with the seller.

Similarly, shared services, like treasury, legal, or tax, may have traditionally been provided by the corporate parent to its subsidiaries and divisions. The costs of these services are rarely allocated on the basis of actual cost and even the audited financial statements will not necessarily reflect the cost of providing these services on a standalone basis.

Frequently, a private equity buyer, such as we have here, is not going to be able to replicate those services right away. Larry and Byron are probably going to have to negotiate a Transition Services Agreement pursuant to which Larry's client will provide these services, say for six months, nine months, or a year, until the private equity firm can replicate them on its own.[16]

Having defined the business and the assets, the next major issue is the choice between a stock and asset deal. Here, the two principal drivers are taxes and liabilities. From a tax perspective, buyers are always going to prefer an asset purchase deal because it gives them the opportunity to allocate the purchase price among the assets being purchased to reflect their fair market value.[17] This results in a step-up of tax basis and allows higher depreciation and amortization deductions going forward, and hence future tax savings. By contrast, in a stock deal, all the tax attributes of the acquired company will carry over and the buyer will lose that ability to step up and achieve a new

16. *See id.* at 11-21.
17. *See Asset Acquisitions*, *supra* note 12, at 926-29.

level of depreciation and amortization deductions from the assets. Consequently, buyers tend to be willing to pay more for assets than stock.

The downside of an asset deal from the seller's perspective is that there is the specter of double taxation. Unless there is a sufficient amount of net operating losses at the acquired company, the corporation is going to recognize taxable gain on the sale, and then when the proceeds are distributed up to the shareholders there will be a second level of taxation, which is very undesirable from the seller's perspective.

The other key issue is liabilities. In a stock transaction, the business is bought "as-is, where-is." The buyer inherits all the obligations, contingent and otherwise, known and unknown, for things like taxes, pensions, and environmental liabilities. By contrast, in an asset purchase, with certain limitations, a buyer can pretty much cherry pick the liabilities it wants to assume.[18]

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18. Section 2.4 of Buyer's Proposed Agreement provides as follows:

2.4 Liabilities

(a) Assumed Liabilities. On the Closing Date, but effective as of the Effective Time, Buyer shall assume and agree to discharge only the following Liabilities of Seller (the "**Assumed Liabilities**"):

(i) any trade account payable reflected on the Interim Balance Sheet (other than a trade account payable to any Shareholder or a Related Person of Seller) which remain unpaid at and are not delinquent as of the Effective Time;

(ii) any trade account payable (other than a trade account payable to any Shareholder or a Related Person of Seller) that have been incurred by Seller in the Ordinary Course of Business between the date of the Interim Balance Sheet and the Closing Date which remains unpaid at and are not delinquent as of the Effective Time;

(iii) any Liability to Seller's customers incurred by Seller in the Ordinary Course of Business for non-delinquent orders outstanding as of the Effective Time reflected on Seller's books (other than any Liability arising out of or relating to a Breach which occurred prior to the Effective Time);

(iv) any Liability to Seller's customers under written warranty agreements in the forms disclosed in Part 2.4(a)(iv) given by Seller to its customers in the Ordinary Course of Business prior to the Effective Time (other than any Liability arising out of or relating to a Breach which occurred prior to the Effective Time);

(v) any Liability arising after the Effective Time under the Seller Contracts described in Part 3.20(a) (other than any Liability arising under the Seller Contracts described on Part 2.4(a)(v) or arising out of or relating to a Breach which occurred prior to the Effective Time);

(vi) any Liability of Seller arising after the Effective Time under any Seller Contract included in the Assets which is entered into by Seller after the date hereof in accordance with the provisions of this Agreement (other than any Liability arising out of or relating to a Breach which occurred prior to the Effective Time); and

(vii) any Liability of Seller described on Part 2.4(a)(vii).

(b) Retained Liabilities. The Retained Liabilities shall remain the sole responsibility of and shall be retained, paid, performed and discharged solely by Seller. "**Retained Liabilities**" shall mean every Liability of Seller other than the Assumed Liabilities, including:

(i) any Liability arising out of or relating to products of Seller to the extent manufactured or sold prior to the Effective Time other than to the extent assumed under Section 2.4(a)(iii), (iv) or (v);

(ii) any Liability under any Contract assumed by Buyer pursuant to Section 2.4(a) which arises after the Effective Time but which arises out of or relates to any Breach that occurred prior to the Effective Time;

(iii) any Liability for Taxes, including (A) any Taxes arising as a result of Seller's operation of its business or ownership of the Assets prior to the Effective Time, (B) any Taxes that will arise as a result of the sale of the Assets pursuant to this Agreement and (C) any deferred Taxes of any nature;

(iv) any Liability under any Contract not assumed by Buyer under Section 2.4(a), including any Liability arising out of or relating to Seller's credit facilities or any security interest related thereto;

(v) any Environmental, Health and Safety Liabilities arising out of or relating to the operation of Seller's business or Seller's leasing, ownership or operation of real property;

(vi) any Liability under the Employee Plans or relating to payroll, vacation, sick leave, worker's compensation, unemployment benefits, pension benefits, employee stock option or profit-sharing plans, health care plans or benefits, or any other employee plans or benefits of any kind for Seller's employees or former employees, or both;

(vii) any Liability under any employment, severance, retention or termination agreement with any employee of Seller or any of its Related Persons;

(viii) any Liability arising out of or relating to any employee grievance whether or not the affected employees are hired by Buyer;

(ix) any Liability of Seller to any Shareholder or Related Person of Seller or any Shareholder;

(x) any Liability to indemnify, reimburse or advance amounts to any officer, director, employee or agent of Seller;

(xi) any Liability to distribute to any of Seller's shareholders or otherwise apply all or any part of the consideration received hereunder;

(xii) any Liability arising out of any Proceeding pending as of the Effective Time, whether or not set forth in the Disclosure Letter;

(xiii) any Liability arising out of any Proceeding commenced after the Effective Time and arising out of, or relating to, any occurrence or event happening prior to the Effective Time;

Here, with respect to liabilities, one of the issues the parties are going to face in the negotiation is whether the environmental liabilities are sufficiently large to cause concern under both federal and state fraudulent conveyance laws.[19] These are a set of laws really designed to protect creditors of a company and it allows a transaction to be avoided by a creditor or a trustee in bankruptcy[20] if the transfer was effectuated

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> (xiv) any Liability arising out of or resulting from Seller's non-compliance with any Legal Requirement or Order of any Governmental Body;
>
> (xv) any Liability of Seller under this Agreement or any other document executed in connection with the Contemplated Transactions; and
>
> (xvi) any Liability of Seller based upon Seller's acts or omissions occurring after the Effective Time.

Acquisition Agreement, *supra* note 8, at 64-66.

19. *Acquisition Agreement*, *supra* note 8, provides the following regarding fraudulent transfers:

> Most jurisdictions have statutory provisions relating to fraudulent conveyances or transfers. The Uniform Fraudulent Transfer Act (**"UFTA"**) and Section 548 of the United States Bankruptcy Code (the **"Bankruptcy Code"**) generally provide that a "transfer" is voidable by a creditor if the transfer is made (i) with actual intent to hinder, delay or defraud a creditor or (ii) if the transfer leaves the debtor insolvent, undercapitalized or unable to pay its debts as they mature, and is not made in exchange for reasonably equivalent value. If a transfer is found to be fraudulent, courts have wide discretion in fashioning an appropriate remedy, and could enter judgment against the transferee for the value of the property, require the transferee to return the property to the transferor or a creditor of the transferor, or exercise any other equitable relief as the circumstances may require. If a good faith transferee gave some value to the transferor in exchange for the property, the transferee may be entitled to a corresponding reduction of the judgment on the fraudulent transfer, or a lien on the property if the court requires its return to the transferor. If the transferor liquidates or distributes assets to its shareholders after the transaction, a court could collapse the transaction and hold that the transferor did not receive any consideration for the assets and that the transferor did not receive reasonably equivalent value for the transfer. *See Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988). The statute of limitations on a fraudulent transfer action can be as long as six years under some states' versions of the UFTA.

Id. at 153.

20. *Acquisition Agreement*, *supra* note 8, provides the following explanation regarding the remedies available to a creditor in a fraudulent transfer:

> The remedies available to a creditor in a fraudulent transfer action include entry of judgment against the transferee for the value of the property at the time it was transferred, entry of an order requiring return of the property to the transferor for satisfaction of creditors' claims, or any other relief the

with either intentional or constructive fraud.[21] Given that intent is very difficult to prove, most fraudulent conveyance claims rely on constructive fraud, which requires proof that the transfer was not made for "reasonably equivalent value," and that the transfer otherwise left the target insolvent,[22]

> circumstances may require. UFTA §§ 7(a), 8(b). Courts have wide discretion in fashioning appropriate remedies.
>
> Even if a transfer is voidable under the UFTA, a good faith transferee is entitled under UFTA § 8, *to the extent of the value given to the transferor*, to (a) a lien on or right to retain an interest in the asset transferred; (b) enforcement of the note or other obligation incurred; or (c) reduction in the amount of the liability on the judgment against the transferee in favor of the creditor. UFTA § 8(d)(1)-(3). If the value paid by the transferee was not received by the transferor, the good faith transferee would not be entitled to the rights specified in the preceding sentence. If the transferor distributed the proceeds of sale, in liquidation or otherwise to its equity holders, a court could collapse the transaction and find that the proceeds were not received by the transferor, thereby depriving the good faith transferee of the rights to offset the value it paid against a fraudulent transfer recovery. With this in mind, a buyer may seek to require that the seller pay all of its retained liabilities prior to making any distribution, in liquidation or otherwise, to its equity holders.

Id. at 155 (emphasis in original).

21. *Acquisition Agreement*, *supra* note 8, outlines the remedies and protections under the Uniform Fraudulent Transfer Act (UFTA) as follows:

> UFTA is structured to provide remedies for creditors in specified situations when a debtor "transfers" assets in violation of UFTA. A "creditor" entitled to bring a fraudulent transfer action is broadly defined as a person who has "a right to payment or property, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." Persons which could be included as creditors under the statute include: noteholders, lessees on capital leases or operating leases, litigants with claims against the seller that have not proceeded to judgment, employees with underfunded pension plans and persons holding claims which have not yet been asserted. There is a presumption of insolvency when the debtor is generally not paying its debts as they become due.
>
> The UFTA avoidance provisions are divided between those avoidable to creditors holding claims at the time of the transfer in issue, and those whose claims arose after the transfer. The statute is less protective of a creditor who began doing business with a debtor after the debtor made the transfer rendering it insolvent. Most fraudulent transfer actions, however, are brought by a bankruptcy trustee, who under Section 544(b) of the Bankruptcy Code, 11 U.S.C. § 544(b) (1994), can use the avoiding powers of any actual creditor holding an unsecured claim who could avoid the transfer under applicable non-bankruptcy law.

Id. at 149-50.

22. *Acquisition Agreement*, *supra* note 8, provides the following discussion regarding the valuation of debts:

undercapitalized, or unable to pay its debts as they become mature.[23] Fraudulent conveyance

> A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation. A significant body of law under the Bankruptcy Code interprets the phrase "at a fair valuation" to mean the amount that could be obtained for the property within a reasonable time by a capable and diligent business person from an interested buyer who is willing to purchase the assets under ordinary selling conditions. A "fair valuation" is not the amount that would be realized by the debtor if it was instantly forced to dispose of the assets or the amount that could be realized from a protracted search for a buyer under special circumstances or having a particular ability to use the assets. For a business which is a going concern, it is proper to make a valuation of the assets as a going concern, and not on an item-by-item basis.

Id.

23. *Acquisition Agreement*, *supra* note 8, explains asset transfer violations under the UFTA as follows:

> An asset transfer would be in violation of UFTA § 4(a)(1), and would be fraudulent if the transfer was made "with actual intent to hinder, delay, or defraud any creditor of the debtor." If "actual intent" is found, it does not matter if value was given in exchange for the assets, or if the seller was solvent. A number of factors (commonly referred to as "badges of fraud") which are to be considered in determining actual intent under UFTA § 4(a)(1) are set out in UFTA § 4(b), and include whether:
>
> (1) the transfer or obligation was to an insider;
>
> (2) the debtor retained possession or control of the property transferred after the transfer;
>
> (3) the transfer or obligation was disclosed or concealed;
>
> (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
>
> (5) the transfer was of substantially all the debtor's assets; . . . [and]
>
> (10) the transfer occurred shortly before or shortly after a substantial debt was incurred.
>
> Although the existence of one or more "badges of fraud" may not be sufficient to establish actual fraudulent intent, "the confluence of several can constitute conclusive evidence of an actual intent to defraud, absent 'significantly clear' evidence of a legitimate, supervening purpose." *Max Sugarman Funeral Home, Inc. v. A.D.B. Investors*, 926 F.2d 1248, 1254-55 (1st Cir. 1991).
>
> An asset purchase may be found to be fraudulent if it was effected by the seller "without receiving a reasonably equivalent value in exchange for the transfer or obligation," and:
>
> (A) the seller's remaining assets, after the transaction, were unreasonably small in relation to the business or transaction that the seller was engaged in or was about to engage in, or
>
> (B) the seller intended to incur, or believed (or should have believed) that it would incur, debts beyond its ability to pay as they became due.
>
> The "unreasonably small assets" test is a distinct concept from insolvency and is not specifically defined by statute. In applying the unreasonably small assets test, a court may inquire whether the seller "has the ability to generate sufficient cash flow on the date of transfer to sustain its operations." *See In re WCC Holding Corp.*, 171 B.R. 972, 986 (Bankr. N.D. Tex. 1994). In pursuing such an inquiry, a court will not ask whether the transferor's cash flow

laws do apply to leveraged asset acquisitions where the proceeds are distributed for shareholders of the acquired company.[24]

The interesting dilemma that we face here is that if Buyer succeeds in getting an asset acquisition structure, the argument by creditors, including the Environmental Protection Agency, is going to be that Buyer did such a good job in negotiation that the assets were sold for less than reasonably equivalent value, and given the size of the environmental liability, the sale rendered the remaining business of Target insolvent.[25] To reduce the fraudulent transfer risk Buyer could get a solvency opinion that, based on the rules and procedures outlined therein, concludes that the transaction would not be a fraudulent transaction,[26] or a third party appraisal of the assets to be transferred which confirms that reasonably equivalent value was to be given for the assets transferred.[27]

Buyer could also seek a representation from Seller such as Section 3.32 of the Proposed Agreement[28] that negates the factual elements

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> projections later proved to be correct, but whether they were reasonable and prudent at the time they were made.

Id. at 150.

24. *See* Robert J. Stearn, Jr. & Cory D. Kandestin, *Delaware's Solvency Test: What Is It and Does It Make Sense? A Comparison of Solvency Tests Under the Bankruptcy Code and Delaware Law*, 36 DEL. J. CORP. L. 165 (2011).

25. *See id.*

26. *See* Robert J. Stearn, Jr., *Proving Solvency: Defending Preference and Fraudulent Transfer Litigation*, 62 BUS. LAW. 359 (2007).

27. *See* Brown v. Third Nat'l Bank (*In re* Sherman), 67 F.3d 1348 (8th Cir. 1995).

28. Section 3.32 of Buyer's Proposed Agreement provides as follows:

> **3.32 Solvency**
>
> (a) Seller is not now insolvent, and will not be rendered insolvent by any of the Contemplated Transactions. As used in this Section, "insolvent" means that the sum Seller's debts and other probable Liabilities exceeds the present fair saleable value of Seller's assets.
>
> (b) Immediately after giving effect to the consummation of the Contemplated Transactions, (i) Seller will be able to pay its Liabilities as they become due in the usual course of its business, (ii) Seller will not have unreasonably small

of a fraudulent transfer and is intended to provide evidence of Seller's sound financial condition and Buyer's good faith. Such a representation may affect the defenses available to Buyer in a fraudulent transfer action, although conclusionary statements in an asset purchase agreement would be of limited value if not supported by the facts.

So at the end, despite Buyer's preference for an asset deal, there are some other factors that limit the structure's usefulness in reducing the liabilities to which Buyer could become subject. Apart from these issues, an asset purchase often requires third-party consents, leases, contracts, and permits.[29] This can open up the opportunity for a counterparty to renegotiate what would otherwise be a very favorable contract.

In addition, there are a lot of mechanics for transfers, documentations, recording taxes, and the like, and as a result, asset deals are much less prevalent. Houlihan Lokey's annual purchase agreement study has shown that from 2002 to 2009, only 18% of the transactions done were asset purchases. Mike, do you want to pick up some of the tax issues?

MICHAEL SCHLER: (Tax Counsel) From a tax perspective, the most important thing is to consult your tax lawyer early and

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capital with which to conduct its present or proposed business, (iii) Seller will have assets (calculated at fair market value) that exceed its Liabilities and (iv) taking into account all pending and threatened litigation, final judgments against Seller in actions for money damages are not reasonably anticipated to be rendered at a time when, or in amounts such that, Seller will be unable to satisfy any such judgments promptly in accordance with their terms (taking into account the maximum probable amount of such judgments in any such actions and the earliest reasonable time at which such judgments might be rendered) as well as all other obligations of Seller. The cash available to Seller, after taking into account all other anticipated uses of the cash, will be sufficient to pay all such debts and judgments promptly in accordance with their terms.

Acquisition Agreement, *supra* note 8, at 148.

29. *See id.* at 7-8.

often in every transaction. The parties failed here by having the term sheet go out without tax advice. It is important to get the tax lawyer involved at the early stages and keep him or her involved at all points because everything that you might think is a minor change in the deal could have disastrous tax consequences to one side or the other.

People say they will do the acquisition by way of a merger.[30] For a tax lawyer, that is a meaningless statement because the tax question is: Which way does the merger go—forward or reverse? If the target merges into the acquiring company or into a subsidiary of the acquiring company, that is an asset sale for tax purposes, and that has all the tax consequences of an asset sale. If the acquiring company sets up a subsidiary that merges into the target, then that is a stock purchase for tax purposes, and it has all of the consequences of a stock purchase. A forward and reverse triangular merger are completely different transactions for tax purposes.

If the target is a C-corporation, which is a regular taxable corporation under the U.S. Internal Revenue Code (***"IRC"***), and the target corporation does an asset sale, there is going to be a corporate-level tax on the gain.[31] That is a 35% federal tax, plus in this case, New York state and New York City taxes (probably the highest in the country combined), so these corporate taxes probably aggregate over 40% net when you take into account the fact that state and local taxes are deductible for federal income tax purposes. Additionally, the shareholders pay taxes on the amounts distributed to them, which can amount to

30. *See Asset Acquisitions*, *supra* note 12, at 926-29.
31. *Id.*

another 15% federal tax and probably another 10% state and local tax. The seller is not left with a whole lot of money, if you have any amount of gain, after it has paid all those taxes at both levels.

On the other hand, if the transaction is treated as a stock sale for tax purposes, whether it is a real stock sale or a merger that is treated as a stock sale, then all you have is the shareholder-level tax, which is capital gains tax at the shareholder level, and the seller has saved that 40% corporate-level tax. It makes a big difference to the seller.

There is a tax advantage for the buyer of buying assets as compared to buying stock because the buyer gets a stepped-up basis in the assets, and it gets to amortize the full cost of the assets rather than whatever the existing tax basis is. Some of that will be amortizable over five to seven years for equipment, but often most of the step-up is amortizable over 15 years if it is an intangible asset like goodwill. So the buyer gets the benefit over 15 years, but the seller has all this upfront tax cost. Thus, on a net basis, there's a lot more being paid to the Internal Revenue Service (the "***IRS***") for an asset sale than a stock sale.

In reality, you are effectively in a partnership with the IRS; for any deal, it is the buyer, the seller, and the IRS. The name of the game is first to minimize what the IRS gets—that maximizes what is left for the other parties. Then the parties can negotiate how they want to divide up what is left, but if the IRS is taking a bigger slice off the top, there is a lot less to divide up between the parties and everybody but the IRS is worse off.

If taxes are the only consideration, first you try to minimize the total taxes on everybody and then you negotiate to divide up what is left. The fact that one party is better off one way and the other party is better off the other way is almost irrelevant. It is a question of what minimizes the total and then who gets the benefit of that.

As the result of this, if the selling corporation is a C-corporation and taxes are the only structuring consideration, you almost always do a stock sale rather than an asset sale. In a relatively closely held business, if all the shareholders are individuals, it is possible that the selling corporation is an S-corporation, which is a pass-through entity, much like a partnership. In that case, there is no separate tax on the corporation itself, so from an income tax point of view, the parties may end up in the same place doing a stock sale or an asset sale. The seller will end up in the same place because there is not that extra level of corporate tax. The corporate level gain passes through to the shareholder and that gain reduces the gain on the liquidation of the company and the distribution of the cash, so the total taxable gain to the seller is the same, generally. The seller may be indifferent in that case to a stock sale or an asset sale, in which case the buyer will still prefer an asset purchase to get the step up in basis on the assets. In that case, since the seller is indifferent and the buyer prefers an asset purchase, you almost always do an asset deal or something treated as an asset deal for tax purposes.

Just one last thing. If you do want to do something that is an asset deal for tax purposes, there are different ways of doing it. You can do a traditional asset sale. You can do a merger of the target into the acquiring company or into a subsidiary of the acquiring company that is treated as an asset sale for tax purposes. Alternatively, you can have the target drop the assets to be sold into a wholly owned limited liability company (***"LLC"***), which can be done in advance of the closing to make the day of closing mechanics easier. Then on the closing, just sell the equity in the LLC. The LLC is treated as a "disregarded entity" for tax purposes, as if it is not there, so when you sell the equity, it is treated like selling assets for tax purposes, and both parties get exactly the same tax treatment as if they were selling assets.[32]

Or suppose it is an S-corporation and you would rather in form sell stock because it is mechanically easier to sell stock than to sell assets. There is an IRC § 338(h)(10) election that the parties can make where, if both parties agree and it is an S-corporation, in form they can sell stock, but it is treated for tax purposes as if it was a sale of assets by the corporation followed by a liquidation of the corporation. There are really two issues: (i) whether you want the transaction treated as a stock sale or asset sale for tax purposes and (ii) depending on the answer to (i), which is the best corporate way to get to the desired result.

LARRY TAFE: (Counsel for Target) Don, tell us about some of the issues that will be faced under DGCL.

DON WOLFE: (Delaware Counsel) One is the appraisal issue. Byron wants a sale of assets, in part because he fears that there will be a post-closing appraisal proceeding in a merger, which may be correct. In a cash merger under the DGCL, appraisal rights are going to arise for stockholders who do not vote

32. *See* Michael L. Schler, *Basic Tax Issues in Acquisition Transactions*, 116 PENN ST. L. REV. 879, 894 (discussing dropdown of assets to LLC and sale of LLC interests).

in favor of the merger, and that would not be the case in a sale of assets.[33] But the appraisal process is not a particularly user-friendly process. The DGCL statutory proceeding imposes filing requirements and deadlines that are strictly enforced.[34] An appraisal proceeding is not something that can be invoked successfully on a whim or a reflex.

Also, while the petitioners in an appraisal action can expect to share fees pro rata with other petitioners, if there were any, they are not going to be able to shift fees to the company as they might in typical class action shareholder litigation, and those expenses are likely to be large. An expert witness on valuation is going to be required. The case is likely to go to trial in the absence of a settlement as an appraisal action does not lend itself to summary judgment. Thus, from a cost and timing standpoint, a DGCL appraisal proceeding is not an attractive strategy unless there are lots of shares and dollars involved, there is much potential upside in the price of the stock, and there are lots of petitioners who have perfected their appraisal rights.

BYRON EGAN: (Counsel for Buyer)

Well, if Larry wishes to assume that risk and indemnify us for any costs of an appraisal proceeding and for any additional consideration that Buyer might have to pay as a result of the appraisal proceeding, then we might take Delaware counsel's advice that appraisal is a risk that Buyer could run.

DON WOLFE: (Delaware Counsel)

Let us talk about stockholder approval in a merger structure.[35] Buyer is apparently

33. DEL. CODE ANN. tit. 8, § 262 (West 2011); *see Fiduciary Duty Cases*, *supra* note 9, at 361-68.

34. *Fiduciary Duty Cases*, *supra* note 9, at 361-68.

35. DGCL §§ 251-58 permit corporations to merge with other corporations if their Boards adopt resolutions approving a plan of merger and the requisite shareholder

concerned about the uncertainty and risk of another bidder seeking to upset the agreed deal while we await shareholder approval of a merger.[36] This concern is understandable given a number of holdings, including *Omnicare*,[37] invalidating a locked up deal upon

approval is obtained. Tit. 8, §§ 251-58. DGCL § 251(c) provides that mergers may be approved by a vote of the holders of a majority of the outstanding shares. *Id.* § 251(c). DGCL § 251(f) permits a merger to be effected without shareholder approval if the corporation is the sole surviving corporation, the shares of stock of the corporation are not changed as a result of the merger and the total number of shares of stock issued pursuant to the merger does not exceed 20% of the shares of the corporation outstanding immediately prior to the merger. *Id.* § 251(f).

36. Under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), director fiduciary duties require robust director involvement in sale of control transactions to confirm that the stockholders are getting the best price reasonably available. Directors fiduciary duties are applicable in the case of closely held corporations as well as corporations whose securities are publicly traded, although the conduct required to satisfy their fiduciary duties will be measured with reference to what is reasonable in the context. *See In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076 (Del. Ch. May 20, 2011); Transcript of Oral Argument, Optima Int'l of Miami, Inc. v. WCI Steel, Inc., No. 3833-VCL (Del. Ch. June 27, 2008) [hereinafter *Optima* Transcript], *available at* http://lawprofessors.typepad.com/mergers/files/_0702120713_001.pdf; Julian v. Eastern States Constr. Serv., Inc., No. 1892-VCP, 2008 WL 2673300 (Del. Ch. July 8, 2008); Byron F. Egan, *Fiduciary Duties of Corporate Directors and Officers in Texas*, 43 TEX. J. BUS. L. 45, 182-183 (Spring 2009), *available at* http://www.jw.com/site/jsp/publicationinfo.jsp?id=1230. *Revlon* does not apply to a sale of assets, including the sale of a subsidiary, unless the transaction involves a sale of control of the company. Even where *Revlon* is not applicable, the directors' fiduciary duty of care still requires directors to use informed business judgment to maximize value in a sale of assets. *See* McPadden v. Sidhu, 964 A.2d 1262 (Del. Ch. 2008). Even in a friendly acquisition, a board's obligations to maximize shareholder values does not cease with the execution of the merger agreement. If a competing acquiror emerges with a serious proposal offering greater value to shareholders (usually a higher price), the board should give it due consideration. A board should seek to maximize its flexibility in responding to a competing bidder by including in the purchase agreement provisions permitting the corporation not only to provide information to a bidder with a superior proposal, but also to negotiate with the bidder, enter into a definitive agreement with the bidder and terminate the existing merger agreement upon the payment of a break-up fee. *See Fiduciary Duty Cases*, *supra* note 9, at 157-59, 243-56.

37. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003), dealt with the interrelationship between a provision in the merger agreement obligating the board to submit the deal to the stockholders (also known as a "force the vote" provision), even if the board subsequently withdraws its recommendation to the stockholders as permitted by DGCL § 146, a voting agreement which essentially obligated a majority of the voting power of the target company's shares to vote in favor of a merger, and the absence of a "fiduciary termination right" in the merger agreement that would have enabled the board of directors to back out of the deal before the merger vote if a better deal comes along.

The decision in *Omnicare* considered a challenge to a pending merger agreement between NCS Healthcare, Inc. and Genesis Health Ventures, Inc. *Id.* at 917-18. Prior to entering into the Genesis merger agreement, the NCS directors were aware that Omnicare was interested in acquiring NCS. *Id.* at 921. In fact, Omnicare had previously submitted proposals to acquire NCS in a pre-packaged bankruptcy transaction. *Id.* NCS, however, entered into an exclusivity agreement with Genesis in early July 2002. *Id.* at 922-23. When Omnicare learned from other sources that NCS was negotiating with Genesis and that the parties were close to a deal, it submitted an offer that would have paid NCS stockholders $3.00 cash per share, which was more than three times the value of the $0.90 per share, all stock, proposal NCS was then negotiating with Genesis. *Id.* at 924. Omnicare's proposal was conditioned upon negotiation of a definitive merger agreement, obtaining required third party consents, and completing its due diligence. *Id.* The exclusivity agreement with Genesis, however, prevented NCS from discussing the proposal with Omnicare. *Id.*

When NCS disclosed the Omnicare offer to Genesis, Genesis responded by enhancing its offer. *Id.* at 924-25. The enhanced terms included an increase in the exchange ratio so that each NCS share would be exchanged for Genesis stock then valued at $1.60 per share. *Id.* But Genesis also insisted that NCS approve and sign the merger agreement as well as approve and secure the voting agreements by midnight the next day, before the exclusivity agreement with Genesis was scheduled to expire. *Id.* at 925. On July 28, 2002, the NCS directors approved the Genesis merger agreement prior to the expiration of Genesis's deadline. *Id.*

The merger agreement contained a "force the vote" provision authorized by DGCL § 146 which required the agreement to be submitted to a vote of NCS's stockholders, even if its board of directors later withdrew its recommendation of the merger (which the NCS board later did). *Id.* In addition, two NCS director-stockholders who collectively held a majority of the voting power, agreed unconditionally and at the insistence of Genesis to vote all of their shares in favor of the Genesis merger. *Id.* at 926. The NCS board authorized NCS to become a party to the voting agreements and granted approval under DGCL § 203, in order to permit Genesis to become an interested stockholder for purposes of that statute. *Id.* The "force the vote" provision and the voting agreements, which together operated to ensure consummation of the Genesis merger, were not subject to fiduciary outs. *Id.*

The Supreme Court of Delaware accepted the Court of Chancery's finding that the NCS directors were disinterested and independent and assumed "arguendo" that they exercised due care in approving the Genesis merger. *Id.* at 929. Nonetheless, the majority held that the "force the vote" provision in the merger agreement and the voting agreements operated in tandem to irrevocably "lock up" the merger and to preclude the NCS board from exercising its ongoing obligation to consider and accept higher bids. *Id.* at 936. Because the merger agreement did not contain a fiduciary out, the Supreme Court held that the Genesis merger agreement was both preclusive and coercive and, therefore, invalid under *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). *Omnicare*, 818 A.2d at 936-39. As an alternative basis for its conclusion, the majority held that under the circumstances the NCS board did not have authority under Delaware law to completely "lock up" the transaction because the defensive measures "completely prevented the board from discharging its fiduciary responsibilities to the minority stockholders when *Omnicare* presented its superior transaction." *Id.* at 936. In so holding, the Court relied on its prior holding in *Paramount Commcunnications, Inc. v. QVC Network, Inc.* that "[t]o the extent that a [merger] contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable." *Id.* (quoting Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 51 (Del. 1994)). Chief Justice Veasey and Justice Steele wrote separate dissents that would have affirmed on the basis that the NCS board's decision was protected by the business judgment rule. *Id.* at 939 (Veasey, C.J., dissenting), 946 (Steele, J., dissenting).

the appearance of a higher bidder before the inevitable stockholder approval was secured. Part of what *Omnicare* holds is that you cannot completely lock up a deal during that window between director approval and shareholder approval.

The question really is whether you can address that problem in a more practical way by actually "dropping a consent"[38] almost immediately upon signing the merger agreement that closes that window up and reduces the possibility that an interloper could appear and weed the regulatory approval as sort of a condition to the closing of the merger.[39] There is not a great deal of law that says one way or another whether you could actually do that, but there is some comfort to be gained from a transcript in *Optima International, Inc. v. WCI Steel International.*[40] *Optima International* was a Vice-Chancellor Lamb opinion holding that a merger provision that required delivery of majority written

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The *Omnicare* decision has important ramifications with regard to deal protection measures in acquisition agreements: First, the decision can be read to suggest a bright-line rule that a "force the vote" provision cannot be utilized in connection with voting agreements locking up over 50% of the stockholder vote unless the board of directors of the target corporation retains for itself a fiduciary out that would enable it to terminate the merger agreement in favor of a superior proposal. Second, the majority's decision confirms that *Unocal's* enhanced judicial scrutiny is applicable to a Delaware court's evaluation of deal protection measures designed to protect an acquisition agreement. Where board-implemented defensive measures require judicial review under *Unocal*, the initial burden is on the defendant directors to demonstrate that they had reasonable grounds for believing that a threat to corporate policy and effectiveness existed and that they took action in response to the threat that was neither coercive nor preclusive and that was within a range of reasonable responses to the threat perceived.

38. "Dropping a consent" refers to having the holders of a majority of the outstanding voting shares execute a written consent approving the transaction.

39. *See Recent Fiduciary Duty Cases*, *supra* note 9, at 255-71.

40. In *Optima International of Miami, Inc. v. WCI Steel, Inc.*, No. 3833-VCL (Del. Ch. June 27, 2008), Vice Chancellor Lamb declined to enjoin a merger that had been approved by the Board of WCI Steel Inc. (a closely held company with 28 stockholders) and adopted by its stockholders later that same day by written consent pursuant to a merger agreement permitting the acquirer to terminate the agreement if stockholder approval was not obtained within 24 hours. *See Optima* Transcript, *supra* note 36, at 117-42.

consent within 24 hours of execution of the merger agreement was perfectly valid, even though it was a *Revlon* case.[41] Vice-Chancellor Lamb explicitly stated that Delaware law does not require that the fiduciary window has to stay open for any significant period of time. So if you grant the point that the continuing duty to recommend a transaction operates only in that window between director approval and stockholder approval, you should feel better about closing the window up quickly and eliminating it by dropping a consent.[42]

41. Plaintiffs argued in *Optima International* that the board "abdicated its authority or delegated its authority to manage the business and affairs of the corporation to the union and that they did so by declining to strenuously challenge the union on its interpretation of the successorship provision." *Id.* at 124. The Court rejected that argument and distinguished the provision in the union contract from an invalid "no-hand poison pill," or the "force-the-vote provision" in *Omnicare*, noting that the successorship provision was not self-imposed, but rather had been approved by the Bankruptcy Court as a condition of WCI's emergence from bankruptcy. *Id.* at 124-25. In response to Plaintiffs' argument that the stockholder vote was a form of a lockup that either exceeded the board's power or resulted in a breach of its fiduciary duties in violation of *Omnicare*, Vice Chancellor Lamb explained:

> But a stockholder vote is not like the lockup in Omnicare. First, it's really not my place to note this, but Omnicare is of questionable continued vitality. Secondly, the stockholder vote here was part of an executed contract that the board recommended after deciding it was better for stockholders to take Severstal's lower-but-more-certain bid than Optima's higher-but-more-risky bid. In this context, the board's discussion reflects an awareness that the company had severe liquidity problems. Moreover, it was completely unclear that Optima would be able to consummate any transaction. Therefore, the stockholder vote, although quickly taken, was simply the next step in the transaction as contemplated by the statute. Nothing in the DGCL requires any particular period of time between a board's authorization of a merger agreement and the necessary stockholder vote. And I do not see how the board's agreement to proceed as it did could result in a finding of a breach of duty.

Id. at 127-28.

42. *Omnicare* was further explained and limited by the Court of Chancery in *In re OPENLANE, Inc. Shareholders Litigation*, No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept. 30, 2011), wherein Vice Chancellor Noble refused to enjoin an all-cash merger transaction negotiated by an actively engaged and independent board, despite the fact that the merger agreement did not contain a fairness opinion or a fiduciary out, and the transaction was effectively locked up by the execution of written consents by a majority of the stockholders on the day following execution of the merger agreement. In the context of a thinly-traded company in which 68.5% of the stock was held by a 16-person group of management and directors, the board negotiated with three potential strategic buyers, but did not undertake a broad auction or contact any possible financial buyers. *Id.* at *1-2. In rejecting the plaintiffs' challenges, the board's decision to contact only

BYRON EGAN: (Counsel for Buyer) Well, if we close the window up though, what about disclosure? Delaware has a fiduciary duty of candor that requires a corporation seeking approval of its shareholders to a proposed sale of substantially all of its assets to provide adequate information to all 30 shareholders to make an informed business decision in voting on the transaction.[43] I have not heard anybody say that because Target is a closely held corporation the fiduciary duty of candor is not applicable. In fact, Don, I think you have educated me in the past that Delaware regards the fiduciary duties to be equally applicable in a closely held corporation, so I am going to presume that you are going to say the same thing applies in this case.

DON WOLFE: (Delaware Counsel) I am.

LARRY TAFE: (Counsel for Target) We would obviously have no reason to say less or to do anything other than what Don advises under Delaware law, even if we have to put together a proxy statement of some kind.

BYRON EGAN: (Moderator) If we are going to do an asset deal, I think we should have the Delaware counsel tell us whether a stockholder approval is required.

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three potential buyers, the lack of a fairness opinion, the lack of a post-signing market check, and the lack of any provision in the merger agreement permitting the directors to terminate it if their fiduciary duties so required, Vice Chancellor Noble reiterated that Delaware does not impose a mandatory checklist of merger features, but cautioned that where "a board fails to employ any traditional value maximization tool, such as an auction, a broad market check, or a go-shop provision, that board must possess an impeccable knowledge of the company's business for the Court to determine that it acted reasonably." *Id.* at *5. *Omnicare* was distinguished on the grounds that the votes were not strictly "locked up" pursuant to a voting agreement, although "after the Board approved the Merger Agreement, the holders of a majority of shares quickly provided consents." *Id.* at *9.

43. *See Recent Fiduciary Duty Cases*, *supra* note 9, at 27-34.

DON WOLFE: (Delaware Counsel)

DGCL § 271 requires stockholder approval if the corporation is purporting to sell all or substantially all of its assets,[44] but as Byron points out, without the risk of appraisal rights ensuing after the transaction. The central question in determining whether you need stockholder approval in that circumstance is: What constitutes all or substantially all? The case law traditionally had been a little uneven on this point. The test since *Gimbel v. Signal*[45] has been to look at both quantitative and qualitative factors, but the decisional law had ranged quite widely. Then in *Katz v. Bregman*[46] a stockholder vote was required where the assets being transferred were in the neighborhood of 50%, which is quite low and it is probably the low-water mark or high-water mark, depending on your point of view in the case law.

In an effort to harmonize the case law, Vice-Chancellor, now Chancellor Strine, declared in *Hollinger* a few years ago that the words "all or substantially all" ought to be given their obvious meaning, which is to say essentially everything, and if there remained a substantial viable ongoing component of the corporation after the sale, then no vote of stockholders would be required under DGCL § 271.[47]

44. In most states, shareholder approval of an asset sale is required if the corporation is selling all or substantially all of its assets. The Delaware courts have used both "qualitative" and "quantitative" tests in interpreting the phrase "substantially all," as it is used in DGCL § 271 which requires stockholder approval for a corporation to "sell, lease or exchange all or substantially all of its property and assets." *See* Thorpe v. CERBCO, Inc., 676 A.2d 436 (Del. 1996) (holding the sale of a subsidiary with 68% of assets, which was primary income generator, to be "substantially all"; seller would be left with only one operating subsidiary, which was marginally profitable).

45. Gimbel v. Signal Co., Inc., 316 A.2d 599 (Del. Ch. 1974) (holding assets representing 41% of net worth but only 15% of gross revenues not to be "substantially all").

46. Katz v. Bregman, 431 A.2d 1274, 1276 (Del. Ch. 1981) (51% of total assets, generating approximately 45% of net sales, held to be "substantially all").

47. Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342 (Del. Ch. 2004), *appeal refused*, 871 A.2d 1128 (Del. 2004). In *Hollinger*, the sale of assets by a subsidiary with

I should mention something about the suggestion that the assets be dropped down into a subsidiary and sold by the subsidiary. There was a time when Delaware practitioners believed that one could escape the DGCL § 271 requirement under the doctrine of independent legal significance[48] by dropping the assets down into a wholly-owned subsidiary and then selling the assets out of the subsidiary. The only vote that would be required in that instance, perhaps, we all

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approval of its parent corporation (its stockholder) but not the stockholders of the parent, was alleged by the largest stockholder of the parent to contravene DGCL § 271. *Id.* at 346-47. Without reaching a conclusion, the Chancery Court commented in dicta that "[w]hen an asset sale by the wholly owned subsidiary is to be consummated by a contract in which the parent entirely guarantees the performance of the selling subsidiary that is disposing of all of its assets and in which the parent is liable for any breach of warranty by the subsidiary, the direct act of the parent's board can, without any appreciable stretch, be viewed as selling assets of the parent itself." *Id.* at 347 (the Court recognized that the precise language of DGCL § 271 only requires a vote on covered sales by a corporation of "its" assets, but felt that analyzing dispositions by subsidiaries on the basis of whether there was fraud or a showing that the subsidiary was a mere alter ego of the parent as suggested in *Leslie v. Telephonics Office Techs., Inc.*, 19 DEL. J. CORP. L. 1237 (Del. Ch. Dec. 30, 1993) was too rigid). Examining the consolidated economics of the subsidiary level sale, the Chancery Court held (1) that "substantially all" of the assets should be literally read, commenting that "[a] fair and succinct equivalent to the term 'substantially all' would be 'essentially everything,'" notwithstanding past decisions that have looked at sales of assets around the 50% level, *Hollinger*, 858 A.2d at 377; (2) that the principal inquiry was whether the assets sold were "quantitatively vital to the operations of" seller, *id.* at 379-82 (the business sold represented 57.4% of parent's consolidated EBITDA, 49% of its revenues, 35.7% of the book value of its assets, and 57% of its asset values based on bids for the two principal units of the parent); (3) that the parent had a remaining substantial profitable business after the sale (the Chancery Court wrote: "if the portion of the business not sold constitutes a substantial, viable, ongoing component of the corporation, the sale is not subject to Section 271," *id.* at 385 (quoting R. FRANK BALOTTI & JESSE A. FINKELSTEIN, 1 THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, § 10.2, at 10-7 (3d ed. Supp. 2004)); and (4) that the "qualitative" test of *Gimbel* focuses on "factors such as the cash-flow generating value of assets" rather than subjective factors such as whether ownership of the business would enable its managers to have dinner with the Queen, *id.* at 383. *See* BALOTTI & FINKELSTEIN, *supra*, § 10.2 (3d ed. Supp. 2009); Mark A. Morton & Michael K. Reilly, *Clarity or Confusion: The 2005 Amendment to Section 271 of the Delaware General Corporation Law*, 10 DEAL POINTS (ABA/Comm. on Negotiated Acquisitions, Chi., Ill.) Fall 2005, at 2; *see also* Subcomm. on Recent Judicial Developments, ABA Negotiated Acquisitions Comm., *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions*, 60 BUS. LAW. 843, 855-58 (2005).

48. *See Fiduciary Duty Cases*, *supra* note 9, at 13 n.66, 295 n.972, 362 n.1210, 363 n.1213.

hoped, was the vote of the parent's board as the stockholder of the subsidiary. But in the wake of dicta in the *Hollinger* opinion, DGCL § 271 was amended to preclude this, and it is now clear that while no vote is required to drop the assets down into a wholly-owned subsidiary, a stockholder vote of the parents' stockholders is required when those assets are sold out of the wholly-owned subsidiary itself.[49]

Also, I should mention a recent decision by the Delaware Supreme Court in the *Liberty Media* case addressing the question whether under indenture language that precluded a sale (without trustee approval) of all or substantially all of the borrower's assets in a transaction or series of transactions, the Court should aggregate a number of transactions that took place over time to decide whether all or substantially all of the assets of the borrower had been sold.[50] The Court essentially declined

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49. *Hollinger*, 858 A.2d at 375. To address the uncertainties raised by dicta in then Vice Chancellor Strine's opinion in *Hollinger*, DGCL § 271 was amended effective August 1, 2005 to add a new subsection (c), which provides as follows:

> (c) For purposes of this section only, the property and assets of the corporation include the property and assets of any subsidiary of the corporation. As used in this subsection, "subsidiary" means any entity wholly-owned and controlled, directly or indirectly, by the corporation and includes, without limitation, corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and/or statutory trusts. Notwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.

75 Del. Laws ch. 30, § 28 (2005) (codified as amended at DEL. CODE ANN. tit. 8, § 271(c) (West 2012)). This amendment answered certain questions raised by *Hollinger*, but raised or left unanswered other questions (e.g., (i) whether subsection (c) applies in the case of a merger of a subsidiary with a third party even though literally read DGCL § 271 does not apply to mergers, (ii) what happens if the subsidiary is less than 100% owned, and (iii) what additional is meant by the requirement that the subsidiary be wholly "controlled" as well as "wholly owned"). *See* Morton & Reilly, *supra* note 47, at 2-13; *cf.* Weinstein Enter., Inc. v. Orloff, 870 A.2d 499 (Del. 2005) (discussing "control" in the context of a DGCL § 220 action seeking inspection of certain documents in the possession of a publicly held New York corporation of which the defendant Delaware corporation defendant was a 45.16% stockholder).

50. Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp., 29 A.3d 225, 243-44 (Del. 2011) (en banc) (held series of dispositions not aggregated in determining whether

	to do that, principally because it was unable to find that the transactions were in any way related or part of an overriding plan to basically liquidate the company, and instead found that they were independently motivated transactions which had the effect of reducing assets individually but should be aggregated for this purpose.
LARRY TAFE: (Counsel for Target)	*Liberty Media* was applying New York law. Would the result be the same for Delaware?
DON WOLFE: (Delaware Counsel)	Yes, the results should be the same in Delaware. There was a lot of evidence in *Liberty Media* put on by the indenture trustee that the asset-to-debt ratio had changed greatly in a way that suggested that the company was really in the end a shadow of what it had been before. The Court appeared to be impressed by the fact that no language addressing those sorts of metrics was included in the indenture in the first place. Had there been, I think that evidence would have been much more persuasive, but as it was, the only language was the language—"in a series of transactions." That was not enough without an overriding purpose to the various acquisitions, which in this case took place over a seven-year period, to justify aggregating the transactions for purposes of this indenture covenant.
BYRON EGAN: (Counsel for Buyer)	In any event, the folks in Texas decided to make life simple. We said you could leverage up a business before selling the assets and change its character, and that would not require shareholder approval. So why not be real simple and say that a transaction does not involve a sale of substantially all of the assets if the company continues in a business after the

they constitute a transfer of "substantially all" of a company's assets under a bond indenture).

transaction is done. The Texas Business Organizations Code (*"TBOC"*) provides, in essence, that shareholder approval is required for an asset sale under Texas law only if it is contemplated that the corporation will cease to conduct any business following the sale of assets.[51]

The Revised Model Business Corporation Act took a similar approach, but it drew the line at 75%,[52] and said that if a corporation after a sale

51. TEX. BUS. ORGS. CODE ANN. § 21.455 (West 2012) requires shareholder approval for a sale of all or substantially all of the corporation's assets, and *id.* § 21.451(2) defines "sale of all or substantially all of the assets" so that it does not encompass any asset sale if afterward the corporation (i) continues to engage in one or more businesses or (ii) applies a portion of the consideration received in the asset sale to the conduct of a business in which the corporation engages after the sale. *See* Byron F. Egan & Curtis W. Huff, *Choice of State of Incorporation—Texas versus Delaware: Is it Now Time to Rethink Traditional Notions?*, 54 SMU L. REV. 249, 287-290 (2001).

Rudisill v. Arnold White & Durkee, P.C., 148 S.W.3d 556 (Tex. Ct. App. 2004), arose out of the combination of Arnold White & Durke, P.C. (*"AWD"*) with another law firm, Howrey & Simon (*"HS"*) pursuant to a combination agreement that provided all of AWD's assets other than those specifically excluded (three vacation condominiums, two insurance policies and several auto leases) were to be transferred to HS in exchange for a partnership interest in HS, which subsequently changed its name to Howrey Simon Arnold & White, LLP (*"HSAW"*). In addition, AWD shareholders were eligible individually to become partners in HSAW by signing its partnership agreement, which most of them did. For business reasons, the AWD/HS combination was submitted to a vote of AWD's shareholders. Three AWD shareholders submitted written objections to the combination, voted against it, declined to sign the HSAW partnership agreement, and then filed an action seeking a declaration of their entitlement to dissenters' rights or alternate relief. *Id.* at 588. The Court accepted AWD's position that these shareholders were not entitled to dissenters' rights because the sale was in the "usual and regular course of business" as AWD continued "to engage in one or more businesses" within the meaning of TEX. BUS. CORP. ACT art. 5.09B (a predecessor to TBOC § 21.451(2)), writing that "AWD remained in the legal services business, at least indirectly, in that (1) its shareholders and employees continued to practice law under the auspices of HSAW, and (2) it held an ownership interest in HSAW, which unquestionably continues directly in that business." *Id.* at 563. The Court further held that AWD's obtaining shareholder approval when it was not required by statute did not create appraisal rights, pointing out that appraisal rights are available under the statute only *"if special authorization of the shareholders is **required**."* *Id.* (emphasis in original); *see also* Subcomm. on Recent Judicial Developments, *supra* note 47, at 855-60.

52. A 1999 revision to the Model Business Corporation Act ("MBCA") excludes from the requirement of a shareholder vote any disposition of assets that would not "leave the corporation without a significant continuing business activity." MODEL BUS. CORP. ACT § 12.02(a). The revision includes a safe harbor definition of significant continuing business activity: at least 25 percent of the total assets and 25 percent of either income (before income taxes) or revenues from pre-transaction operations. *Id.*

of assets retains 25% of the total assets that it had before the transaction, or either 25% of the income before taxes or 25% of the revenues, then it would not be a sale of substantially all of the assets or require shareholder approval. It seems that Chancellor Strine in *Hollinger* has articulated a standard in Delaware that is functionally similar to the standard in Texas or under the Revised Model Business Corporation Act.

LARRY TAFE: (Counsel for Target)

If we go the asset route, we add another party to the transaction—the people with whom our company has contracts that have to be assigned, including the lease that has been mentioned. We will have to go to them, seek their consent to the assignments of their contracts, and effectively give them opportunities to try to wring out a little more than the current obligations entail, which could be a very serious problem.

BYRON EGAN: (Counsel for Buyer)

Let us talk about your merger approach then. If we do a merger, we still have to deal with the contracts that have restrictions on assignments in them. In an asset transaction, one of the logistical difficulties that the parties face is getting the consent of the counterparties to the contracts or intellectual property licenses. If we do a merger, we say that a merger by state law is not an assignment. Does the DGCL say that a merger is not an assignment?

Well, it doesn't say that.[53] There is

53. DGCL § 259(a) provides as follows:

When any merger or consolidation shall have become effective under this chapter, for all purposes of the laws of this State the separate existence of all the constituent corporations, or of all such constituent corporations except the one into which the other or others of such constituent corporations have been merged, as the case may be, shall cease and the constituent corporations shall become a new corporation, or be merged into 1 of such corporations, as the case may be, possessing all the rights, privileges, powers and franchises as well

DON WOLFE:
(Delaware Counsel)

considerable precedent under Delaware law to the effect that a contractual non-assignment clause is not triggered by a stock purchase agreement unless it expressly so provides, but the Court of Chancery recently declined to dismiss a claim that a reverse triangular merger (that is a merger that preserved the corporate identity of the original party to the contract in question) constituted an assignment in the context of contractual language that precluded assignment "by operation of law or otherwise."[54] The court in that case recognized the existing precedent that stock acquisitions did not result in assignment, but noted that mergers (even reverse triangular mergers) were not necessarily the same thing. Vice Chancellor Parsons suggested that an assignment was a particular kind of transaction and that adding the phrase "by operation of law" really did not add much. I believe that the

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> of a public as of a private nature, and being subject to all the restrictions, disabilities and duties of each of such corporations so merged or consolidated; and all and singular, the rights, privileges, powers and franchises of each of said corporations, and all property, real, personal and mixed, and all debts due to any of said constituent corporations on whatever account, as well for stock subscriptions as all other things action or belonging to each of such corporations shall be *vested in the corporation surviving* or resulting from such merger or consolidation; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation as they were of the several and respective constituent corporations, and the title to any real estate vested by deed or otherwise, under the laws of this State, in any of such constituent corporations, shall not revert or be in any way impaired by reason of this chapter; but all rights of creditors and all liens upon any property of any of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said surviving or resulting corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it.

DEL. CODE ANN. tit. 8, § 259(a) (2011) (emphasis added).

54. Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH, No. 5589-VCP, 2011 WL 1348438, at *11-13 (Del. Ch. Apr. 8, 2011) (Delaware Chancery Court declined to dismiss a claim that a reverse triangular merger effected an assignment of rights under a contract which required consent for assignments "by operation of law or otherwise," but noted that it might reach the conclusion on summary judgment or after trial and that whether a reverse triangular merger effects an assignment by operation of law requiring contractual consent is an area unsettled under Delaware law).

result was largely because it was on a motion to dismiss and he felt the words were sloppy enough to suggest that there was some ambiguity there, but he did indicate that on summary judgment he might very well change his mind once he had been assured that there was no evidence in the negotiation history that would suggest what the parties intended.

RICHARD De ROSE: (Investment Banker) Was the court influenced by the fact that subsequently the company basically fired all the employees and liquidated the company? Do you think that was a factor?

DON WOLFE: (Delaware Counsel) That clearly was a factor and it was recited in the opinion. I do not know that it should have been a factor necessarily in construing the contract language, but it clearly was a fact that moved the Vice Chancellor in this particular instance.

LARRY TAFE: (Counsel for Target) Sounds like we are coming full circle to that wonderful term sheet.

BYRON EGAN: (Counsel for Buyer) No, I think we are coming full circle to an asset transaction because I think that what Don has told us is that there is some uncertainty under Delaware law as to whether, for Delaware law purposes, a merger would be an assignment. In Texas, our statute specifically provides that a merger is not an assignment and we have case law that says the statute means what it says and that is the result.[55] But that is not the complete

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55. While DGCL § 259(d) provides that all of the rights of the constituent corporations shall be vested in the surviving corporation without reference to whether the merger constitutes an assignment, TBOC § 10.008 expressly provides that a merger is not an assignment as follows:

(a) When a merger takes effect:

(1) the separate existence of each domestic entity that is a party to the merger, other than a surviving or new domestic entity, ceases;

(2) all rights, title, and interests to all real estate and other property owned by each organization that is a party to the merger is allocated to and vested, subject to any existing liens or other encumbrances on the

answer because this deal involves intellectual property.

Under federal law, and remember when the feds get involved, they begin to say that their law trumps state law, we have a series of cases, such as *Cincom Systems v. Novelis Corporation*.[56] *Cincom Systems* is a 2009 Sixth Circuit Case in which the Court held that under federal law, intellectual property rights are not assignable, even indirectly, as part of a business combination unless the owner of the intellectual property rights has agreed otherwise. Thus, we need to look very carefully at all of Target's license agreements to consider whether or not under the terms of these licenses and under federal law there would be an approval required. Nonetheless, that is something that is doable and we would have to do that even in a merger. So, why not go ahead and do an asset transaction?

LARRY TAFE: (Counsel for Target) But you wouldn't have to do it with a sale of stock.

BYRON EGAN: (Moderator) So Michael, can we avoid these transfer restrictions and get a good tax result?

MICHAEL SCHLER: (Tax Counsel) An asset sale will be treated as an asset sale for tax purposes, but if the seller is an S-corporation, you can do a stock sale and elect to treat it as an asset sale for tax purposes and

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property, in one or more of the surviving or new organizations as provided in the plan of merger *without*;

(A) reversion or impairment;

(B) any further act or deed; or

(C) any transfer or assignment having occurred.

Tex. Bus. Org. Act Ann. § 10.008(a) (West 2012) (emphasis added).

56. Cincom Sys. v. Novelis Corp., 581 F.3d 431, 435-36 (6th Cir. 2009) (holding that internal forward merger between sibling entities constituted an impermissible software license transfer, notwithstanding a state corporation statute that provided that a merger vests title to assets in the surviving corporation without any transfer having occurred).

get the tax results of an asset sale, but without a physical transfer of assets.[57] I think under the anti-assignment provisions, since the corporation is still there with the same assets, a stock sale would not violate the anti-assignment restrictions. By the way, a sale of stock of an S-corporation also probably avoids state sales taxes, because in form there is no transfer of assets; it is just deemed a transfer of assets for federal income tax purposes.[58]

RICHARD DE ROSE: (Investment Banker) Frances, please explain to us how this would play out in Europe, depending on whether the transaction is structured as a stock sale, a merger, or an asset sale. In particular, first assume that Target is a UK company and in the alternative that Buyer is a UK company, with Target remaining a Delaware corporation. Would the analysis change at all if Target dropped its assets to an LLC subsidiary and sold the LLC to Buyer?

FRANCES MURPHY: (European Counsel) I should start off by saying that I am an English lawyer and this panel talks about Europe. Although we have a common union and some countries have a common currency, but not the UK, the law is quite different in each jurisdiction. There are some common rules. There are some common baselines. One of the things you have to think about when you are looking at an acquisition of a European company is where it is incorporated and what the laws of that particular country are. You should not assume that they will be the same. There is particularly a big difference between common law jurisdictions, like the UK, and the civil code based jurisdictions, like France, Italy, and Spain.

57. *See Asset Acquisitions*, *supra* note 12, at 926-29.
58. *Id.*

If Target were a UK company, we would be looking at the same sorts of issues as you have heard discussed earlier today regarding asset sale versus share sale. If Buyer does do a share sale, then Buyer gets the whole thing, warts and all. Buyer gets all the liabilities and has multiple sellers to deal with.

If we were doing an asset sale, Buyer would be worrying about how it can get contracts across and how it can deal with the transaction taxes. From a seller's point of view, the stock sale in the UK would be preferable; and if you only want some of the assets, then you would probably prefer to do an asset sale. Sometimes people get so worried about some issues that they will insist on an asset sale, even though transaction costs for an asset sale can be quite high because we have different levels of transaction taxes depending on the type of assets being transferred. A stock deal will attract tax at 1/2%, whereas assets can attract much higher rates—some going up to 5%. So all things to be taken into account, the same sorts of issues apply to assets or stock deals. It is ultimately a matter of negotiation.

There are other structures available, particularly in Europe where mergers are a more common method of bringing two companies together, but we do not really do those in the UK for private company deals.

If Buyer was a UK company buying an American company, the main issue that you would be looking at is the corporate governance issues around what Buyer has to do in order to authorize this acquisition. That would depend on whether Buyer is a listed company or not. If it is a private company, like the private equity Buyer in this case, only board authorization would be required to effect the transaction. If Buyer were, in contrast, an English listed company, then under our stock exchange rules, if this was a significant acquisition, then it would require a shareholder approval before Buyer could make the acquisition. That would have to be a condition of the transaction.

Just going back to asset deals for a moment, we were talking about cherry picking liabilities. One particular issue that is common across Europe relates to employees. If you buy a business, you cannot generally leave the employees behind. They would all automatically transfer across with the business. If you want to lay them off, the buyer and seller can agree amongst themselves who pays what costs, but for the employees themselves, they automatically go to the new employer.

BYRON EGAN: (Moderator) That is a pretty important distinction. In the U.S., very often when you buy assets, you cherry pick the employees that you want to take and leave the rest behind.

III. CONFIDENTIALITY AND EXCLUSIVITY AGREEMENTS; LETTERS OF INTENT

BYRON EGAN: (Moderator) Larry, are you going to want a confidentiality agreement in this deal?

LARRY TAFE: (Counsel for Target) I would like to have a confidentiality agreement, certainly if you are going to be interested in doing any due diligence or seeing any of our records.

RICHARD DE ROSE: (Investment Banker) Irrespective of whether a deal is an asset deal, a stock purchase, or a merger, the first document that the parties are likely to execute is in fact the confidentiality agreement.[59] Contrary to popular belief, these agreements are not boilerplate documents and, not infrequently, they have resulted in litigation. There are, however, certain key provisions that have relatively standard contours.

The definition of "confidential information" is important. Seller will want a very broad definition that includes any written, electronic, or oral information that gets passed along, along with Buyer's notes, analyses, or anything else based on that information. Buyer is probably going to be successful in getting some standard exceptions for information that is generally publicly known, information that was available to Buyer before getting information from Seller, information received from a third party that was not subject to a confidentiality obligation, and for information that was otherwise independently developed by Buyer.

Another issue will be who is a permitted recipient of the confidential information provided. Buyer will want a broad definition that includes Buyer's bankers, lawyers, accountants, employees, and directors. Seller, on the other hand, will try to limit the number of recipients who can get that information and will probably try to require those people to be bound by the confidentiality agreement or at least to be informed of the existence of the agreement and an oral assurance that they'll abide by it.

The buyer is typically permitted to disclose confidential information pursuant to a

59. *See Acquisition Agreement*, *supra* note 8, app. B; *see also* Richard E. Climan et al., *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 PENN ST. L. REV. 615, app. A at 701 (2012).

subpoena or other legal process, but the seller often seeks to require that the buyer make some level of effort in obtaining confidentiality treatment by the court or the regulatory agency.

One of the more hotly negotiated topics is non-solicitation of employees. Seller is going to want a very broad provision restricting Buyer's solicitation of or employment of Seller's employees, but Buyer is going to want to try to limit it to the people that it has met during the due diligence process. Frequently, the compromise is that the buyer is restricted from soliciting certain high level people across the board and then certain people that may have been met in due diligence.

Confidentiality agreements usually have a limited term, on average probably two to three years, but with respect to a company that has very mission-critical information, you may see a bifurcation where things like intellectual property and other things of that sort may have a longer term to them. The confidentiality agreement usually provides that the provision of information does not create a license by virtue of giving away the information and that agreement does not constitute an agreement to go into the transaction.

BYRON EGAN: (Counsel for Buyer) Normally I would ask that Target sign an exclusivity agreement providing that Target will not negotiate with any other party for a specified period,[60] because Buyer does not wish to spend money on due diligence and trying to develop an agreement unless it knows it has a deal. Buyer wants to be able to do its due diligence and then sit down and negotiate a transaction. Like in a public transaction, in a

60. For forms of exclusivity agreement, see Climan, *supra* note 59, app. C-D at 704-710.

private deal it is very typical for a buyer, at this stage after the confidentiality agreement is done or maybe even in the confidentiality agreement, to have a very broad exclusivity agreement with the seller to the effect that the company and its shareholders will not entertain any offers from any other parties, will not shop the deal, and will not negotiate with anybody else.

Now, in this particular circumstance, knowing that Mr. Tafe is an obstructionist and would want to know what the terms of the deal would be before signing some exclusivity arrangement, we have presented a form of letter of intent.[61] It is a very standard letter of intent that says that it is intended to put forth the essence of the deal before we start drafting a definitive agreement, and it generally provides that its provisions are not binding on the parties, at least not the description of the deal terms, but there are a few binding provisions like who is going to pay the expenses and that Seller is not going to negotiate with third parties while we are trying to develop a deal. A letter of intent will be sufficient for the parties to make their Hart-Scott-Rodino Act filings.[62] Our proposed letter of intent provides that neither Target nor its shareholders will directly or indirectly solicit or entertain offers from; negotiate with; or in any manner encourage, discuss, accept, or consider any proposal of any other person in connection with a possible acquisition of Target or any of its assets.

LARRY TAFE: (Counsel for Target) I am not sure we are at a point in this deal where we are in a position to agree that we will

61. *See Acquisition Agreement*, *supra* note 8, app. C.

62. See the definition of HSR Act and related Comment in *id.* at 46-48. See also the form of Letter of Intent in *id.* at app. C.

deal exclusively with Buyer in this particular case. However, on the assumption that we could get to enough of those terms, I certainly have no problem in principle in giving Buyer a certain period of time to complete its due diligence[63] and have a definitive agreement which is binding.

BYRON EGAN: (Counsel for Buyer) Six months is fair.

LARRY TAFE: (Counsel for Target) No, six months is too long. Target would agree to pay a termination fee that is contingent upon Target's breach of the exclusivity agreement, but Target would want a breakup fee if Buyer decides to walk away as the company will have been off the market and has been in this state of suspension with all the employees worried about their future. If you just kick tires enough and then say you do not want to do this deal, the letter of intent will be nonbinding on both of us, but if you walk and it is not us who walks or our fault, Buyer should pay a breakup fee.

I'd also like to know from Don what the Delaware law would do with respect to Target's board locking up the company for a period of time with an exclusivity agreement and also the issue of the letter of intent being nonbinding.

DON WOLFE: (Delaware Counsel) Well, there's unfortunately not a great deal of law on this issue. It seems to be the emerging view on the part of at least Vice Chancellor Laster and Chancellor Strine, however, that provisions of a letter of intent that do not recite that they are to be nonbinding warrant judicial respect and should be enforced, and that exclusivity, no shop, and the similar provisions

63. *See* Manual on Acquisition Review (Am. Bar Ass'n 1995).

> are important contractual rights that are bargained over, as you have just seen, and they are unlikely to be adequately protected by a contractual breach of contract damages remedy, which to me means you might even be able to get an injunction to enforce them.[64]
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> The further view seems to be that these provisions do not have inherent fiduciary outs[65] that will be read into them, nor are they invalid because they do not expressly so provide.[66] That does not mean that leaving out a fiduciary out provision is a good idea from the standpoint of the seller's board, because it is putting itself between a rock and a hard place between the contract and the board's fiduciary obligations.

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64. In *Global Asset Capital, LLC v. Rubicon US REIT, Inc.*, No. 5071-VCL (Del. Ch. Nov. 16, 2009), in the context of explaining why he granted a temporary restraining order enjoining the target and its affiliates from disclosing any of the contents of a letter of intent or soliciting or entertaining any third-party offers for the duration of the letter of intent, Vice Chancellor Laster wrote:

> [I]f parties want to enter into nonbinding letters of intent, that's fine. They can readily do that by expressly saying that the letter of intent is nonbinding, that by providing that, it will be subject in all respects to future documentation, issues that, at least at this stage, I don't believe are here. I think this letter of intent is binding. . . . [A] no-shop provision, exclusivity provision, in a letter of intent is something that is important. . . . [A]n exclusivity provision or a no-shop provision is a unique right that needs to be protected and is not something that is readily remedied after the fact by money damages. . . . [C]ontracts, in my view, do not have inherent fiduciary outs. People bargain for fiduciary outs because, as our Supreme Court taught in Van Gorkom, if you do not get a fiduciary out, you put yourself in a position where you are potentially exposed to contract damages and contract remedies at the same time you may potentially be exposed to other claims. Therefore, it is prudent to put in a fiduciary out, because otherwise, you put yourself in an untenable position. That doesn't mean that contracts are options where boards are concerned. Quite the contrary. And the fact that equity will enjoin certain contractual provisions that have been entered into in breach of fiduciary duty does not give someone carte blanche to walk as a fiduciary. . . . I don't regard fiduciary outs as inherent in every agreement.

Transcript of Argument and Ruling on Motion for Temporary Restraining Order and Motion to Expedite at 89-91, *Global Asset Capital*, No. 5071-VCL.

65. *See supra* note 64; *see also Fiduciary Duty Cases*, *supra* note 9, at 255-67 (discussing the concept of fiduciary out).

66. See the Preliminary Note to form of Letter of Intent in *Acquisition Agreement*, *supra* note 8, app. C at 1-10.

It is important to remember that a letter of intent is just a piece of the process, and a preliminary piece at that, so granting exclusivity rights early on is not, *per se*, a breach of fiduciary duty so long as you respect your obligations under *Revlon*, *Unocal*, or *Ace*[67] to vet the process before submitting it to stockholder approval. There is plenty of time after the letter of intent expires to do that in one way or another.

BYRON EGAN: (Counsel for Buyer) So you will not let us simply have a six-month period to negotiate this deal and then after we have negotiated this deal, drop the consent the next day?

DON WOLFE: (Delaware Counsel) No. I think in that situation the court would expect that the board would have preserved fiduciary outs in the letter of intent, or not signed it at all, so that they could comply with their obligation to make sure that was the best deal available.

RICHARD DE ROSE: (Investment Banker) Frances, what would be the practice in Europe or the UK?

FRANCES MURPHY: (European Counsel) Well, again quite similar. We would have the same sorts of discussions about whether you want the letter of intent. Are you going to end up doing two negotiations? If you are going to negotiate the letter of intent and then you are going to negotiate the real agreement, why not just jump to the real agreement? We certainly do frequently have letters of intent and we frequently have exclusivity arrangements.

It is possible to make the letter of intent nonbinding. In the UK, you would make that clear in the agreement itself and you would make it subject to contract. You would say,

67. ACE Ltd. v. Capital Re Corp., 747 A.2d 95 (Del. Ch. 1999).

"This is not a contract. The contract is coming."

In the rest of Europe, especially the more civil law based jurisdictions, it is sometimes not so clear and you need to be very careful that you get advice as to how to write it into your document for the particular jurisdiction to make it nonbinding because certainly in France, Italy, Germany, and Holland they may look at pre-contracts as being potentially enforceable.

Regarding exclusivity arrangements, again in the UK, we have quite a clear position. We have a judgment from the House of Lords (now the Supreme Court) saying that lockouts are enforceable, so you can agree, as Byron is asking, that you will not talk to somebody else and you will not entertain negotiations with another party for a limited period of time, and that will depend on the circumstances of the case as to what is reasonable. I tend to think six months would be too long.

BYRON EGAN: (Moderator) What would be a proper period?

FRANCES MURPHY: (European Counsel) Maybe two months, but it depends on the circumstances and how difficult you think it is going to be to do the due diligence on the business.

A lockout agreement in the UK is fine. A lock-in agreement—you will negotiate with me over the next few months—is not enforceable in the UK. The court would say you cannot force someone to talk. The contrasting point, I think, is that in Europe you need to be aware of implied obligations to negotiate in good faith, because in some jurisdictions there is an implied obligation, once you sign a letter of intent and agree that you are going to have discussions about a deal, that you will actually have those discussions. That can be an enforceable obligation. Breach of an implied duty of good faith may give rise to damages and costs and possibly extend to damages for loss of bargain. Beware of what you are getting into when you start doing deals in continental Europe.

The final point I was going to make is that in some jurisdictions, if you sign a letter of intent, that may start to trigger filing obligations. Thus, you need local advice before you put pen to paper.

IV. SELECTED ASSET PURCHASE AGREEMENT PROVISIONS

RICHARD DE ROSE: (Investment Banker) Byron has agreed not to pursue a letter of intent and instead has sent Larry last night the Proposed Agreement, which is Byron's standard form of asset acquisition agreement[68] and is based on a draft of the ABA Model Asset Purchase Agreement. Byron suggests he and Larry get together to go over his form of Proposed Agreement and see if there are any issues.

A. Sufficiency of Assets

LARRY TAFE: (Counsel for Target) There are some issues that I would just like to put on the table at the outset. Your representation in Section 3.6 of the Proposed Agreement, which provides simply that the assets being sold are sufficient to run the business,[69] is not appropriate for this proposed

68. *See Acquisition Agreement, supra* note 8, at 28-298.
69. Section 3.6 of the Buyer's Proposed Agreement provides:
3.6 Sufficiency of Assets

transaction. I understand that such provisions are sometimes appropriate in a transaction where a seller would be selling a division and you have everything carved out of the seller to enable a buyer to operate with the purchased assets, or if you are purchasing a subsidiary that is reliant upon services being provided by the parent, that a buyer would want assurance that it is getting all that you need to run the business free from other parts of the enterprise. Here, however, we are selling you the entire business and all you have to do is look at it to see whether Target has sufficient assets. Target has financial statements, equipment, and an inventory of widgets. Why do we need Section 3.6?

BYRON EGAN: (Counsel for Buyer)

Well, if it is as easy as you are saying, and this provision is just words on a piece of paper, then Seller should not have any problem with the representation in Section 3.6 of the Proposed Agreement. On the other hand, there are frequently situations where all of the assets to run this business are not really on the balance sheet of the business or owned by the business, but rather, for example, the founder of the company could have some intellectual property, maybe patent rights used in the company that we are buying. Perhaps there is a blocking patent that lurks somewhere in the background that the founder of the company has never gotten around to assigning to the company.

To guard against a situation surfacing where Buyer buys the assets of this business and begins to run it, and then the founder comes

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> Except as disclosed in Part 3.6, the Assets (a) constitute all of the assets, tangible and intangible, of any nature whatsoever, necessary to operate Seller's business in the manner presently operated by Seller and (b) include all of the operating assets of Seller.

Acquisition Agreement, *supra* note 8, at 107.

forth and says that your operations are going to infringe my personal patent that I did not assign to the company, and, therefore, ante up or stop using that intellectual property to manufacture your products.

So, in order to give Buyer a claim for breach of the agreement in the event that happens, we would have a provision like Section 3.6 which says except as you have told us, the assets that we are buying constitute all of the assets, tangible and intangible, necessary to run the business that we are purchasing. Simple as that.

B. Taxes

LARRY TAFE: (Counsel for Target) I want to talk about the tax representation in Section 3.14 of the Proposed Agreement.[70]

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70. Section 3.14 of the Buyer's Proposed Agreement provides as follows:
3.14 TAXES
(a) Tax Returns Filed and Taxes Paid. Seller has filed or caused to be filed on a timely basis all Tax Returns and all reports with respect to Taxes that are or were required to be filed pursuant to applicable Legal Requirements. All Tax Returns and reports filed by Seller are true, correct and complete in all material respects. Seller has paid, or made provision for the payment of, all Taxes that have or may have become due for all periods covered by the Tax Returns or otherwise, or pursuant to any assessment received by Seller, except such Taxes, if any, as are listed in Part 3.14(a) and are being contested in good faith and as to which adequate reserves (determined in accordance with GAAP) have been provided in the Balance Sheet and the Interim Balance Sheet. Except as provided in Part 3.14(a), Seller currently is not the beneficiary of any extension of time within which to file any Tax Return. No claim has been made within the preceding five years by any Governmental Body in a jurisdiction where Seller does not file Tax Returns that it is or may be subject to taxation by that jurisdiction. There are no Encumbrances on any of the Assets that arose in connection with any failure (or alleged failure) to pay any Tax.
(b) Delivery of Tax Returns and Information Regarding Audits and Potential Audits. Seller has delivered or made available to Buyer copies of all Tax Returns filed since _______, 20__. The federal income Tax Returns of Seller have been audited by the IRS or are closed by the applicable statute of limitations for all taxable years through ______, 20__. Part 3.14(b) contains a complete and accurate list of all Tax Returns that are currently under audit or for which Seller has received written notice of a pending audit, and Seller has provided to Buyer information concerning any deficiencies or other amounts that are currently being contested. All deficiencies proposed as a result of such

audits have been paid, reserved against, settled, or are being contested in good faith by appropriate proceedings as described in Part 3.14(b). Seller has delivered, or made available to Buyer, copies of any examination reports, statements or deficiencies, or similar items with respect to such audits. There is no dispute or claim concerning any Taxes of Seller claimed or raised by any Governmental Body in writing. Part 3.14(b) contains a list of all Tax Returns for which the applicable statute of limitations has not run. Except as described in Part 3.14(b), Seller has not given or been requested to give waivers or extensions (or is or would be subject to a waiver or extension given by any other Person) of any statute of limitations relating to the payment of Taxes of Seller or for which Seller may be liable.

(c) Proper Accrual. The charges, accruals, and reserves with respect to Taxes on the Records of Seller are adequate (determined in accordance with GAAP) and are at least equal to Seller's liability for Taxes. There exists no proposed tax assessment or deficiency against Seller except as disclosed in the [Interim] Balance Sheet or in Part 3.14(c).

(d) Specific Potential Tax Liabilities and Tax Situations.

(i) Withholding. All Taxes that Seller is or was required by Legal Requirements to withhold, deduct or collect have been duly withheld, deducted and collected and, to the extent required, have been paid to the proper Governmental Body or other Person.

(ii) Tax Sharing or Similar Agreements. There is no tax sharing agreement, tax allocation agreement, tax indemnity obligation or similar written or unwritten agreement, arrangement, understanding or practice with respect to Taxes (including any advance pricing agreement, closing agreement or other arrangement relating to Taxes) that will require any payment by Seller.

(iii) Consolidated Group. Seller (A) has not been a member of an affiliated group within the meaning of Code Section 1504(a) (or any similar group defined under a similar provision of state, local or foreign law), and (B) has no liability for Taxes of any person (other than Seller and its Subsidiaries) under Reg. §1.1502 6 (or any similar provision of state, local or foreign law), as a transferee or successor by contract or otherwise.

(iv) S Corporation. Seller is not an S corporation as defined in Code Section 1361.

ALTERNATIVE No. 1:

Seller is an S corporation as defined in Code Section 1361 and Seller is not and has not been subject to either the built in gains tax under Code Section 1374 or the passive income tax under Code Section 1375.

ALTERNATIVE No. 2:

Seller is an S corporation as defined in Code Section 1361 and Seller is not subject to the tax on passive income under Code Section 1375, but is subject to the built in gains tax under Code Section 1374, and all tax liabilities under Code Section 1374 though and including the Closing Date have been or shall be properly paid and discharged by Seller.

INCLUDE WITH BOTH ALTERNATIVE No. 1 AND No. 2:

Part 3.14(d)(iv) lists all the states and localities with respect to which Seller is required to file any corporate, income or franchise tax returns and sets forth whether Seller is treated as the equivalent of an S corporation by or with respect to each such state or locality. Seller has properly filed Tax Returns with and paid and discharged any

Target does not have a problem with representing that there will be no tax liabilities or tax liens or the like that will carry over to Buyer and for which Buyer would be responsible. I do not think 14 paragraphs of tax reps are necessary for an asset deal, although they may be appropriate in a stock deal or a merger. If it becomes an asset deal, you start on day one from scratch, and Target's historical tax returns ought to be about as interesting to you as grass growing.

MICHAEL SCHLER: (Tax Counsel) I am sympathetic with Larry as Section 3.14 is lengthy and would be much more appropriate for a stock deal than an asset sale. That is not to say that a buyer of assets does not normally expect the seller to give a certain number of reps, because the buyer of assets can be assuming unpaid property and similar taxes. In addition, the buyer might have to pay state sales taxes because nobody ever complies with the Bulk Sales Laws, and so in theory the buyer can be subject to state sales taxes if there are liens on the assets.[71]

Also, a buyer will often want to know generally what the tax status is of the business, because even though it is not liable for the taxes of the seller and is starting over with new taxes and new tax returns, it is the same business and so they have to file tax returns in the same places. Very often there is the question, depending on how the business is operating in different states, what state tax returns it has to file. So it is good to know

liabilities for taxes in any states or localities in which it is subject to Tax.

(v) Substantial Understatement Penalty. Seller has disclosed on its federal income Tax Returns all positions taken therein that could give rise to a substantial understatement of federal income Tax within the meaning of Code Section 6662.

Id. at 110-12.

71. *See id.* at 170-73.

some things like where is the seller filing, and has any tax authority in a different state ever claimed that taxes were due. Even though the buyer is not responsible for the past, the buyer may have the same issue with the tax authority. So to some extent, the buyer has an interest in what has been going on with the business tax wise, but it is still true that in a stock sale you care a lot more than in an asset sale.

Personally, I think this whole issue about the scope of the tax representations is really a sideshow. The real issue in an agreement like this is what is the scope of the indemnity for pre-closing taxes. Whether it is a stock deal or an asset deal, Buyer will want Seller to give an absolute first dollar indemnity for every dollar of pre-closing taxes that might arise, and Seller will say no. Then you will fight over that and what the scope of indemnity is.

But if Buyer gets its indemnity, it does not really care about the reps anymore because the indemnity covers all of the taxes that might arise. You might care about the reps a little bit because it could affect post-closing taxes if there is a breach of rep, but the vast majority of what Buyer cares about would be picked up if they get an indemnity for all pre-closing taxes. You can fight all day about the scope of the reps, but the real issue is the scope of the indemnity.

BYRON EGAN: (Counsel for Buyer) But the indemnity is post-closing and the correctness of the representations is a condition to Buyer's obligation to close. Then we have the issue of rescission, and if you have a misrepresentation then we may find that you have misled us and we have a ground for a rescission.[72] Having a representation, as well

72. *See id.* at 267-69.

as in the indemnity, is an advantage to Buyer.

MICHAEL SCHLER: (Tax Counsel) Now, that is a good point. If Buyer discovers the representations are just lies, then if it is significant enough, Buyer does not have to close. However, that is a fairly extreme case and most sellers will be careful and not have their representations be so inaccurate. There is a reason for a seller to be careful about what representations it is giving, but assuming it is not lying, the seller really is not giving the buyer any right not to close and the real issue is the indemnity.

BYRON EGAN: (Counsel for Buyer) But there is also the issue of information. Part of the function of any representation is to gather information, and what kind of taxes this business has been paying is fairly important for Buyer's understanding what kind of business and what kind of tax risks it may have going forward. So, while the esteemed tax counsel was pointing out things from a tax perspective, a very conservative buyer that does not want to lose money on this deal is going to ask for as much protection as can be negotiated.

MICHAEL SCHLER: (Tax Counsel) Those are good points.

C. Disclosure/Entire Agreement

LARRY TAFE: (Counsel for Target) There is another representation that I like less than even those other two. Section 3.33[73] of

73. Section 3.33 of the Buyer's Proposed Agreement provides as follows:
3.33 Disclosure
(a) No representation or warranty or other statement made by Seller or either Shareholder in this Agreement, the Disclosure Letter, any supplement to the Disclosure Letter, the certificates delivered pursuant to Section 2.7(b) or otherwise in connection with the Contemplated Transactions contains any untrue statement or omits to state a material fact necessary to make any of them, in light of the circumstances in which it was made, not misleading.

the Proposed Agreement is just called "Disclosure," which is benign, but it is basically a Rule 10b-5[74] representation on steroids. Section 3.33 essentially says that no representation or warranty or other statement made by seller or any shareholder made in this agreement or any supplemental delivered pursuant to the Proposed Agreement or otherwise in connection with the contemplated transactions contains any untrue statement or omits to state a material fact necessary to make them any of them in light of the circumstances.

I really object to that one. I think it is a "gotcha" rep. As I mentioned before, you have 32 reps before that. This is Section 3.33, and Sections 3.1 to 3.32 already cover more ground than you could ever need. You drafted them. It just is not appropriate to get to the end of all that and say "oh by the way, if I forgot to ask for something or if by any chance there's an omission that would make something misleading, then I get to back out of the deal or seek indemnity." Section 3.33 is a formula that was devised, and has survived the test of time, for people selling securities in the public market with documents that they prepare unilaterally that do not get any negotiation, and that do not have any due diligence, or have any opportunity to ask questions. Section 3.33 is inappropriate here.

If there is a misrepresentation in the Proposed Agreement, you do not need Section 3.33 to tell you that sellers promise that they have not

(b) Seller does not have Knowledge of any fact that has specific application to Seller (other than general economic or industry conditions) and that may materially adversely affect the assets, business, prospects, financial condition, or results of operations of Seller that has not been set forth in this Agreement or the Disclosure Letter.

Id. at 151.

74. 17 C.F.R. § 240.10b-5 (2011).

said something phony elsewhere in the Proposed Agreement. To the extent that Section 3.33 begins to bring in notions of omissions, we suddenly have an obligation to make sure that you have asked for what you need.

BYRON EGAN: (Moderator)

That is the "trust me" defense, and representing Buyer, I would not buy into that. Now Larry has got a fair point here, and I am going to step out of my normal aggressive Buyer's counsel role on this issue. Section 3.33 says that no representation, etc. is incorrect, but then it says, "in this agreement or otherwise." What those little words "or otherwise" do is pick up all that Richard De Rose, as investment banker, has communicated during the course of trying to get the Buyer enticed into the transaction—some of those emails may have been a bit more flowery than in retrospect would be desirable—and whatever else may have been picked up in Buyer's due diligence.

Further, this is an asset transaction and SEC Rule 10b-5 is not applicable because we do not have a security. If the assets being sold did include securities then perhaps this asset purchase would be in connection with the sale of a security.

Then Rule 10b-5 also includes the requirements of reliance and scienter. Section 3.33 of the Proposed Agreement simply says no statement that was made anywhere in the course of this transaction is incorrect. That is a very significant representation contractually. If I am representing Seller, I will want to contractually limit Sellers' exposure for extra contractual representations. I am going to ask Buyer to disclaim having relied on the stuff in the data room or otherwise not in the four corners of the Proposed Agreement.

> Now, if I am representing Buyer, I am going to object and say Seller is defrauding Buyer if the projections Seller gave Buyer are wrong. Buyer relied on what you were telling it in the data room. We want you to be telling us the truth because we are relying on you and expect to hold you accountable if anything proves to be incorrect.
>
> Larry is going to ask for a provision that says "[a]ll representations and warranties set forth in this Agreement are contractual in nature only and subject to the sole and exclusive remedies set forth [in this agreement]."[75] So the only remedy that is going to be available to Buyer is going to be the indemnification provisions in the Proposed Agreement. Those provisions are going to have caps and baskets and procedures for certain claims and times for asserting claims. So, sellers are going to attempt to circumscribe the horizon and limit a claim for fraudulent inducement. In order to negate a possible claim for fraudulent inducement, the seller is going to ask the buyer to say in expansive language that "except for the representations and warranties expressly made in this agreement that there is no other representation and warranty that has been made, express or implied, in law or otherwise." The essence of Seller's position is the Proposed Agreement contains all of the promises that have been made by Seller about this company, and if it is not in the four corners of the Proposed Agreement, then it has not been relied on.

75. Glenn D. West & Benton Lewis, Jr., *Contracting to Avoid Extra-Contractual Liability—Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 BUS. LAW. 999, 1037 (2009); *see* Byron F. Egan et al., *Contractual Limitations on Seller Liability in M&A Agreements*, *in* University of Texas School of Law 7th Annual Mergers and Acquisitions Institute, Dallas, TX (Oct. 20, 2011), *available at* http://images.jw.com/com/publications/1669.pdf.

Then you move to Section 13.7 of the Proposed Agreement,[76] the essence of which is that "this agreement supersedes all prior agreements, whether written or oral, between the parties with respect to the subject matter including any letter of intent, any confidentiality agreement, etc." This is intended to mean that the Proposed Agreement is the entire agreement of the parties and contains all of the provisions to which the parties have agreed.[77]

There have been a number of recent cases, particularly in Texas, dealing with the enforceability of non-reliance and entire agreement provisions. The *Italian Cowboy* case[78] was a Texas Supreme Court holding that a merger clause like Section 13.7 will not negate a fraud in the inducement claim unless it is expressly inclusive of words disclaiming

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76. Section 13.7 of the Buyer's Proposed Agreement provides:

> **13.7 Entire Agreement and Modification**
>
> This Agreement supersedes all prior agreements, whether written or oral, between the parties with respect to its subject matter (including any letter of intent and any confidentiality agreement between Buyer and Seller) and constitutes (along with the Disclosure Letter, Exhibits and other documents delivered pursuant to this Agreement) a complete and exclusive statement of the terms of the agreement between the parties with respect to its subject matter. This Agreement may not be amended, supplemented or otherwise modified except by a written agreement executed by the party to be charged with the amendment.

Acquisition Agreement, *supra* note 8, at 266.

77. *See* Dujardin v. Liberty Media Corp., 359 F. Supp.2d 337, 356 (S.D.N.Y. 2005) ("It is generally understood that the purpose of an integration clause 'is to require full application of the parol evidence rule in order to bar the introduction of extrinsic evidence to vary or contradict the terms of the writing.'") (quoting Primex Int'l Corp. v. Wal-Mart Stores, 89 N.Y.2d 594, 599 (N.Y. Ct. App. 1997). If the parties want any pre-existing agreements between the parties regarding the acquisition (such as the confidentiality agreement or certain provisions in the letter of intent) to remain in effect, this Section 13.7 would have to be revised accordingly. If the seller wants to contractually negate that the seller had made any representations beyond those expressly set forth in Article 3, the seller should consider a more expansive entire agreement and non-reliance provision such as the alternate Section 13.7 Entire Agreement, Non-reliance, Exclusive Remedies and Modification provisions set forth *infra*, text following note 80.

78. Italian Cowboy Partners, Ltd. v. Prudential Ins. Co., 341 S.W.3d 323 (Tex. 2011) (limiting effect of merger clause without additional disclaimer of reliance on representations).

reliance on representations made prior to the signing of the contract. That was followed by the *Allen* case,[79] which said that such a provision must be specifically bargained for and cannot be boilerplate. Then the last case in the trilogy, *Staton Holdings*,[80] said that the express negligence doctrine,[81] which we have in Texas and which actually exists in a slightly different form in Delaware, applies to non-reliance provisions and requires that the communication of extraordinary shifting of risks needs to be in express, clear, conspicuous language (in Texas, we advise our clients that conspicuous means it should be in boldface type). As a result of these three Texas cases, an entire agreement/non-reliance provision that a seller might seek could read as follows:

> 13.7 Entire Agreement, Non-reliance, Exclusive Remedies and Modification
>
> (a) This Agreement supersedes all prior agreements, whether written or oral, between the parties with respect to its subject matter (including any letter of intent and any confidentiality agreement between Buyer and Seller) and constitutes (along with the Disclosure Letter, Exhibits and other documents delivered pursuant to this Agreement) a complete and exclusive statement of the terms of the agreement between the

79. Allen v. Devon Energy Holdings, L.L.C., ___ S.W.3d ___, 2011 WL 3208234 (Tex. Civ. App. 2011) (holding that a release without an express disclaimer of reliance was ineffective to limit fraudulent inducement claim; must show use of negotiation rather than boilerplate provisions).

80. Staton Holdings, Inc. v. Tatum, L.L.C., 345 S.W.3d 729 (Tex. Civ. App. 2011) (discussing express negligence and inclusion of conspicuous, bold face type provisions).

81. *See id.* at 733-35 (outlining Texas's express negligence jurisprudence); *see also* Fina, Inc. v. ARCO, 200 F.3d 266 (5th Cir. 2000) (applying Delaware law and holding that the indemnification provision did not satisfy the Delaware requirement that indemnification provisions be clear and unequivocal). For additional discussion, see *Acquisition Agreement*, *supra* note 8, at 238-40 (suggesting and discussing an asset agreement provision for indemnification in case of strict liability or indemnitee negligence).

parties with respect to its subject matter. This Agreement may not be amended, supplemented or otherwise modified except by a written agreement executed by the party to be charged with the amendment.

(b) Except for the representations and warranties contained in Article 3, none of Seller or any Shareholder has made any representation or warranty, expressed or implied, as to Seller or as to the accuracy or completeness of any information regarding Seller furnished or made available to Buyer and its representatives, and none of Seller or any Shareholder shall have or be subject to any liability to Buyer or any other Person resulting from the furnishing to Buyer, or Buyer's use of or reliance on, any such information or any information, documents or material made available to Buyer in any form in expectation of, or in connection with, the transactions contemplated by this Agreement.

(c) Following the Closing, the sole and exclusive remedy for any and all claims arising under, out of, or related to this Agreement, or the sale and purchase of the Seller, shall be the rights of indemnification set forth in Article 11 only, and no person will have any other entitlement, remedy or recourse, whether in contract, tort or otherwise, it being agreed that all of such other remedies, entitlements and recourse are expressly waived and released by the parties hereto to the fullest extent permitted by law. [Notwithstanding the foregoing, the parties have agreed that if the Buyer can demonstrate, by clear and convincing evidence, that a material representation and warranty made by the Seller or the Selling Shareholder in this Agreement was deliberately made and known to be materially untrue by any of the Seller Knowledge Parties, then the Deductible shall not apply and the Cap shall be increased to the Purchase Price with respect to any resulting indemnification claim under Section 11.2.]

(d) The provisions of this Section 13.7, together with the provisions of Sections 3.33 and 3.34, and the limited remedies provided in Article 11, were specifically bargained for between Buyer and Sellers and were taken into account by Buyer and the Sellers in arriving at the Purchase Price. The Sellers have specifically relied upon the provisions of this Section 13.7, together with the provisions of Sections 3.33 and 3.34, and the limited remedies provided in Article 11, in agreeing to the Purchase Price and in agreeing to provide the specific representations and warranties set forth herein.

(e) All claims or causes of action (whether in contract or in tort, in law or in equity) that may be based upon, arise out of or relate to this Agreement, or the negotiation, execution or performance of this Agreement (including any representation or warranty made in or in connection with this Agreement or as an inducement to enter into this Agreement), may be made only against the entities that are expressly identified as parties hereto. No Person who is not a named party to this Agreement, including without limitation any director, officer, employee, incorporator, member, partner, stockholder, Affiliate, agent, attorney or representative of any named party to this Agreement ("Non-Party Affiliates"), shall have any liability (whether in contract or in tort, in law or in equity, or based upon any theory that seeks to impose liability of an entity party against its owners or affiliates) for any obligations or liabilities arising under, in connection with or related to this Agreement or for any claim based on, in respect of, or by reason of this Agreement or its negotiation or execution; and each party hereto waives and releases all such liabilities, claims and obligations against any such Non-Party Affiliates. Non-Party Affiliates are expressly intended as third party beneficiaries of this provision of this Agreement.

(f) This Agreement may not be amended, supplemented or otherwise modified except by a written agreement executed by the party to be charged with the amendment.[82]

While the foregoing provision is lengthy and is intended to address the concerns expressed by the courts in the *Italian Cowboy*, *Allen*, and *Staton Holdings* cases, circumstances and future cases will no doubt suggest revision of the foregoing in particular cases.

AUDIENCE MEMBER: Do those Texas cases involve sophisticated purchases represented by counsel?

BYRON EGAN: (Moderator) Yes. The sophistication of the parties and their representation by counsel is key to the enforceability of a provision like the above Section 13.7. Protecting unsophisticated investors is certainly something courts will do. In the *Allen* case, the seller was a partner in a major Houston law firm and the other party to the transaction was a former partner of a major

82. This alternative Section 13.7 is derived from the Model Provisions suggested in West, *supra* note 75, at 1038, as well as the *Italian Cowboy, Allen*, and *Staton Holdings* cases discussed above. *See also* Byron F. Egan et al., *Contractual Limitations on Seller Liability in M&A Transactions*, *in* ABA Section of Business Law Spring Meeting Program on "Creating Contractual Limitations on Seller Liability that Work Post-Closing: Avoiding Serious Pitfalls in Domestic and International Deals," Denver, Colo. (April 22, 2010), *available at* http://images.jw.com/com/publications/1362.pdf.

Dallas law firm. These people knew what they were doing, and they were also crafty. When one side wanted to change the deal that had been agreed to, it found that the release language left out some of the magic words. It is kind of like the difference between the right word and the almost right word can be the difference between lightning bolt and lightning bug. A non-reliance provision needs to be inclusive and tailored to the particular transaction. It must expressly disclaim reliance on any representations that are not embodied in the four corners of the agreement, and perhaps even in the particular enumerated sections thereof. It should say that no reliance has been placed on any statements made by any representatives of any of the parties in any data room or by any affiliate of any party. It should state that fraud in the inducement claims are being released.

DON WOLFE: (Delaware Counsel) The leading Delaware case on this topic is a case called *ABRY Partners v. F&W Acquisition*,[83] another then Vice Chancellor

83. ABRY Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032 (Del. Ch. 2006). In *ABRY*, a stock purchase agreement included a merger clause, or a "buyer's promise," that it was not relying upon any representations and warranties not stated in the contract. The Delaware Chancery Court wrote that such provisions are generally enforceable:

> When addressing contracts that were the product of give-and-take between commercial parties who had the ability to walk away freely, this court's jurisprudence has . . . honored clauses in which contracted parties have disclaimed reliance on extra-contractual representations, which prohibits the promising party from reneging on its promise by premising a fraudulent inducement claim on statements of fact it had previously said were neither made to it nor had an effect on it.
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> * * *
>
> The teaching of this court . . . is that a party cannot promise, in a clear integration clause of a negotiated agreement, that it will not rely on promises and representations outside of the agreement and then shirk its own bargain in favor of a "but we did rely on those other representations" fraudulent inducement claim. The policy basis for this line of cases is, in my view, quite strong. If there is a public policy interest in truthfulness, then that interest applies with more force, not less, to contractual representations of fact. Contractually binding, written representations of fact ought to be the most

Strine decision from 2006. In that case the court held that reliance clauses of this sort are typically enforceable. It would be, in the view of our court, inequitable and contrary to public policy for a sophisticated commercial party to state affirmatively in the contract that it was relying only on the contractual representations and warranties, and then attempt to avoid the effect of that statement by claiming that in fact that wasn't true and that it has been fooled by the express contractual promise that was made. It is worth remembering that public policy for years precluded these kinds of provisions on the assumption that the law abhors fraudulent conduct. *ABRY* represents a derogation of the common law, and there are some exceptions that continue to exist. One exception to *ABRY* is along the lines that Byron has already described: if the provision is less than clear, less than explicit or murky or otherwise ambiguous on the point, the parties remain responsible for any fraudulent representations made outside the agreement, notwithstanding the inclusion of this sloppy language.

> reliable of representations, and a law intolerant of fraud should abhor parties that make such representations knowing they are false.
>
> * * *
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> Nonetheless, . . . we have not given effect to so-called merger or integration clauses that do not clearly state that the parties disclaim reliance upon extra-contractual statements. Instead, we have held . . . that murky integration clauses, or standard integration clauses without explicit anti-reliance representations, will not relieve a party of its oral and extra-contractual fraudulent representations. The integration clause must contain "language that . . . can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract's four corners in deciding to sign the contract." This approach achieves a sensible balance between fairness and equity—parties can protect themselves against unfounded fraud claims through explicit anti-reliance language. If parties fail to include unambiguous anti-reliance language, they will not be able to escape responsibility for their own fraudulent representations made outside of the agreement's four corners.

Id. 1056-59 (citations omitted). In *ABRY*, however, the court allowed a fraud claim to proceed where, notwithstanding a clear anti-reliance provision, the plaintiff alleged that the defendant had intentionally lied within the four corners of the agreement. *See* West, *supra* note 75, at 1023-24.

The second exception, which is perhaps a bit murky itself, is that such provisions will not exculpate intentional fraud or lying with respect to provisions that are stated in the contract itself. So we are not talking about extra contractual promises here, but misrepresentations relating to affirmative statements, either covenants or representations, in the agreement itself. This latter exception is illuminated by the recent decision by Chancellor Chandler in *OverDrive v. Baker & Taylor*,[84] which involved a joint venture agreement that explicitly recited that it was to be an exclusive distribution arrangement

84. *ABRY* was explained and limited in *OverDrive, Inc. v. Baker & Taylor, Inc.*, 2011 WL 2448209 (Del.Ch. June 17, 2011), which arose out of a failed joint venture in which defendant allegedly breached its promises to exclusively distribute plaintiff's audiobooks and other digital media to defendant's books and physical media customers. The joint venture agreement provided that "[n]either party is relying on any representations, except those set forth herein, as inducement to execute this Agreement." *Id.* at *6. Plaintiff alleged that defendant intentionally lied about specific provisions in the agreement in failing to reveal plans to use digital media information received from plaintiff in digital media arrangements with competitors. *Id.* at *7. In denying defendant's motion to dismiss, Chancellor Chandler wrote:

> Under the teaching of *ABRY Partners V, L.P. v. F&W Acquisition LLC*, use of an anti-reliance clause in such a manner is contrary to public policy if it would operate as a shield to exculpate defendant from liability for its own intentional fraud—"there is little support for the notion that it is efficient to exculpate parties when they lie about the material facts on which a contract is premised." Defendant responds that the public policy exception in *ABRY* is limited to situations where a defendant "intentionally misrepresents a fact embodied in a contract," and that the only alleged misrepresentations at issue in this case are pre-contractual statements that were not embodied in the Agreement. I decline to accept defendant's argument because, as noted earlier, Baker & Taylor's (alleged) misrepresentations and omissions with respect to LibreDigital (both the true nature of its relationship and its intention to develop a competitive digital distribution platform) relate directly to Section 10.1 and Schedule J of the Agreement and, indeed, go to the very core of the Agreement between OverDrive and Baker & Taylor. Such material misrepresentations and omissions in the Agreement—if proven to be true—frustrate the very purpose and nature of the Agreement, and OverDrive purportedly would not have entered into the Agreement with Baker & Taylor otherwise. Although the language of the anti-reliance clause in the Agreement is clear and unambiguous, I conclude that it is barred by public policy at this stage, construing facts and inferences in plaintiff's favor and accepting the allegations in the Complaint as true.

Id. at *6.

between the two parties. It was alleged in the complaint that that wasn't true, and that in fact one of the joint ventures had an arrangement with someone else and it was by no means exclusive. In taking up that allegation, the court reaffirmed the holding in *ABRY*, but held that the *ABRY* holding did not go so far as to insulate contracting parties from intentional misrepresentation, or lying, with respect to provisions that are actually in the contract itself, at least at the pleading stage. In other words, you cannot fraudulently induce someone to waive a claim for fraudulent inducement.

BYRON EGAN: (Moderator) I think that Delaware and Texas have similar principles applicable to entire agreement and non-reliance provisions.

D. Survival of Representations; Indemnity

BYRON EGAN: (Moderator) The entire agreement and non-reliance provisions tie into the indemnification provisions. Anytime you are dealing with a negotiated purchase of a closely held business, the indemnification provisions are going to be key provisions in your agreement. In the Proposed Agreement, we have a provision that the representation and warranties will survive the closing.[85] There are specific

85. Section 11.1 of the Proposed Agreement provides as follows:

11.1 Survival

All representations, warranties, covenants, and obligations in this Agreement, the Disclosure Letter, the supplements to the Disclosure Letter, the certificates delivered pursuant to Section 2.7, and any other certificate or document delivered pursuant to this Agreement shall survive the Closing and the consummation of the Contemplated Transactions, subject to Section 11.7. The right to indemnification, reimbursement, or other remedy based on such representations, warranties, covenants and obligations shall not be affected by any investigation (including any environmental investigation or assessment) conducted with respect to, or any Knowledge acquired (or capable of being acquired) at any time, whether before or after the execution and delivery of this indemnification provisions for misrepresentations, for liabilities that were associated with the business that were not assumed, and for any liabilities arising out of the operation of the business before the closing.[86] There are provisions dealing with

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Agreement or the Closing Date, with respect to the accuracy or inaccuracy of or compliance with, any such representation, warranty, covenant or obligation. The waiver of any condition based on the accuracy of any representation or warranty, or on the performance of or compliance with any covenant or obligation, will not affect the right to indemnification, reimbursement, or other remedy based on such representations, warranties, covenants and obligations.

Acquisition Agreement, *supra* note 8, at 203.

86. Section 11.2 of the Proposed Agreement provides:

11.2 Indemnification and Reimbursement by Seller and Shareholders

Seller and each Shareholder, jointly and severally, will indemnify and hold harmless Buyer, and its Representatives, shareholders, subsidiaries, and Related Persons (collectively, the "**Buyer Indemnified Persons**"), and will reimburse the Indemnified Persons, for any loss, liability, claim, damage, expense (including costs of investigation and defense and reasonable attorneys' fees and expenses) or diminution of value, whether or not involving a Third Party Claim (collectively, "**Damages**"), arising from or in connection with:

(a) any Breach of any representation or warranty made by Seller or either Shareholder in (i) this Agreement (without giving effect to any supplement to the Disclosure Letter), (ii) the Disclosure Letter, (iii) the supplements to the Disclosure Letter, (iv) the certificates delivered pursuant to Section 2.7 (for this purpose, each such certificate will be deemed to have stated that Seller's and Shareholders' representations and warranties in this Agreement fulfill the requirements of Section 7.1 as of the Closing Date as if made on the Closing Date without giving effect to any supplement to the Disclosure Letter, unless the certificate expressly states that the matters disclosed in a supplement have caused a condition specified in Section 7.1 not to be satisfied), (v) any transfer instrument or (vi) any other certificate, document, writing or instrument delivered by Seller or either Shareholder pursuant to this Agreement;

(b) any Breach of any covenant or obligation of Seller or either Shareholder in this Agreement or in any other certificate, document, writing or instrument delivered by Seller or either Shareholder pursuant to this Agreement;

(c) any Liability arising out of the ownership or operation of the Assets prior to the Effective Time other than the Assumed Liabilities;

(d) any brokerage or finder's fees or commissions or similar payments based upon any agreement or understanding made, or alleged to have been made, by any Person with Seller or either Shareholder (or any Person acting on their behalf) in connection with any of the Contemplated Transactions;

(e) any product or component thereof manufactured by or shipped, or any services provided by, Seller, in whole or in part, prior to the Closing Date;

(f) any matter disclosed in Parts _____ of the Disclosure Letter;

(g) any noncompliance with any Bulk Sales Laws or fraudulent transfer law in respect of the Contemplated Transactions;

caps, baskets, limitations on the amount that can be claimed, any deductibles from the indemnification claims, and mechanisms for asserting indemnification claims.[87]

Don, you have a recent Delaware case where Chancellor Strine has dealt with some of these provisions?

DON WOLFE: (Delaware Counsel) The case is *GRT v. Marathon GTF Technology*.[88] It is a decision in July 2011 by Chancellor Strine holding that a provision in a joint venture contract[89] that specific representations and warranties would survive for one year and thereafter terminate, along with any remedy for breach thereof, effectively operated to shorten the statute of limitations with respect to claims relating to those representations. In so holding, Chancellor Strine very helpfully addressed the effect of several different, but typical kinds of

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> (h) any liability under the WARN Act or any similar state or local Legal Requirement that may result from an "**Employment Loss**", as defined by 29 U.S.C. § 2101(a)(6), caused by any action of Seller prior to the Closing or by Buyer's decision not to hire previous employees of Seller;
> (i) any Employee Plan established or maintained by Seller; or
> (j) any Retained Liabilities.

Acquisition Agreement, *supra* note 8, at 213-14.

87. *See Acquisition Agreement*, *supra* note 8, 228-240.

88. GRT, Inc. v. Marathon GTF Technology, LTD, No. 5571-CS, 2011 WL 2682898 (Del. Ch. July 11, 2011) (Delaware Chancellor Strine in granting a motion to dismiss held that a provision in a joint venture contract that particular representations would survive for one year, and thereafter terminate along with any remedy for breach thereof, effectively operated to shorten the statute of limitations with respect to claims relating to those representations).

89. The survival provision at issue in *GRT* read as follows:

> The representations and warranties of the Parties contained in Sections 3.1, 3.3, 3.6, 4.1 and 4.2 shall survive the Closing indefinitely, together with any associated right of indemnification pursuant to Section 7.2 or 7.3. The representations and warranties of [GRT] contained in Section 3.16 shall survive until the expiration of the applicable statutes of limitations . . . , and will thereafter terminate, together with any associated right of indemnification pursuant to Section 7.3. All other representations and warranties in Sections 3 and 4 will survive for twelve (12) months after the Closing Date, and will thereafter terminate, together with any associated right of indemnification pursuant to Section 7.2 or 7.3 or the remedies provided pursuant to Section 7.4.

Id. at *7.

provisions that are included in agreements like the Proposed Agreement. *First*, a provision that the representations and warranties terminate upon closing, which he indicated means that they can no longer provide any basis post-closing for a suit for misrepresentation. *Second*, a provision for a discreet survival period during which representations and warranties will continue to be binding on the party who made them, the effect of this being to limit the time period during which a claim for breach may be filed.[90] *Third*, a provision that representations and warranties survive indefinitely, which means that the applicable statute of limitations period applies. The general rule to be gleaned from *GRT* is that when representations and warranties terminate, so does the right to sue on those representations and warranties, and secondly, that you cannot extend the applicable statute of limitations period beyond that which is in effect by contract under any circumstances, so the maximum amount of time that you are going to have to claim indemnification is the legal statute of limitations period.

BYRON EGAN: (Moderator) An asset purchase agreement typically has baskets or deductibles that must be exceeded before any indemnification is owed by the seller,[91] caps on the maximum amount of

90. Some state statutes limit the ability of parties to limit by contract the applicable statutory statute of limitations. *See, e.g.*, TEX. CIV. PRAC. & REM. CODE § 16.070 (2010) ("[A] person may not enter into a stipulation...or agreement that purports to limit the time in which to bring suit [thereon] to a period shorter than two years [and one that does] is void in this state"; provided that the foregoing "does not apply to a stipulation...or agreement relating to the sale or purchase of a business entity if a party [thereto] pays or receives or is obligated to pay or entitled to receive consideration [thereunder] having an aggregate value of not less than $500,000.").

91. Section 11.5 of the Proposed Agreement provides a deductible for certain kinds of claims as follows:

11.5 Limitations on Amount—Seller and Shareholders

Seller and Shareholders shall have no liability (for indemnification or otherwise) with respect to claims under Section 11.2(a) until the total of all damages that can be claimed,[92] and the periods for asserting claims.[93] A buyer is going to say,

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> Damages with respect to such matters exceeds $_____________, and then only for the amount by which such Damages exceed $_____________. However, this Section 11.5 will not apply to claims under Section 11.2(b) through (i) or to matters arising in respect of Sections 3.9, 3.11, 3.14, 3.22, 3.29, 3.30, 3.31 or 3.32 or to any Breach of any of Seller's and Shareholders' representations and warranties of which the Seller had Knowledge at any time prior to the date on which such representation and warranty is made or any intentional Breach by Seller or either Shareholder of any covenant or obligation, and Seller and the Shareholders will be jointly and severally liable for all Damages with respect to such Breaches.

Acquisition Agreement, *supra* note 8, at 228. Section 11.5 provides a safety net, or "basket," with respect to specified categories of indemnification, but does not establish a ceiling, or "cap." The basket is a minimum amount that must be exceeded before any indemnification is owed—in effect, it is a deductible. The purpose of the basket or deductible is to recognize that representations concerning an ongoing business are unlikely to be perfectly accurate and to avoid disputes over insignificant amounts. In addition, the buyer can point to the basket as a reason why specific representations do not need materiality qualifications.

A more aggressive buyer may wish to provide for a "threshold" deductible (sometimes called a "tipping basket") that, once crossed, entitles the indemnified party to recover all damages, rather than merely the excess over the basket. A "threshold" alternative provides in relevant part as follows:

> (a) If the Closing occurs, Sellers shall have no liability with respect to claims under Section 11.2(a) until the aggregate of all Losses suffered by all Buyer Indemnified Persons with respect to such claims exceeds $_____________; provided, however, that if the aggregate of all such Losses exceeds $_____________, Sellers shall be liable for all such Losses.

Acquisition Agreement, *supra* note 8, at 228. In the Proposed Agreement, the representations are generally not subject to materiality qualifications, and the full dollar amount of damages caused by a breach must be indemnified, subject to the effect of the basket established by Section 11.5. This framework avoids "double dipping" in which a seller contends that the breach exists only to the extent that it is material, and then the material breach is subjected to the deduction of the basket. If the acquisition agreement contains materiality qualifications to the seller's representations, the buyer may consider a provision to the effect that such a materiality qualification will not be taken into account in determining the magnitude of the damages occasioned by the breach for purposes of calculating whether they are applied to the basket; otherwise, the immaterial items may be material in the aggregate, but not applied to the basket.

92. The sellers' argument for a maximum indemnifiable amount is that they had limited liability as shareholders and should be in no worse position with the seller having sold the assets than they were in before the seller sold the assets; this argument may not be persuasive to a buyer that views the assets as a component of its overall business strategy or intends to invest additional capital. If a maximum amount is established, it often does not apply to certain kinds of claims, such as liabilities for taxes, environmental matters, or ERISA matters, for which the buyer may have liability under applicable law, or defects in the ownership of the purchased assets. Separate limits may be negotiated for different kinds of liabilities.

93. Section 11.7 of the Proposed Agreement provides as follows:

> **11.7 Time Limitations**

we will agree to those things, but we are going to have an exception for fraud.[94] Fraud comes in a variety of flavors, so what you mean should be defined.[95] Is it a constructive fraud? Is it intentional fraud? Is it negligent misrepresentation, which is in specie of fraud? What is it? If a party is going to be forced to agree to a fraud exception, then consider defining what you mean. For example, do you mean a deliberate misrepresentation so you get away from negligence? Does it have to be material? Does it have to have been relied upon by the other party? These are sensitive issues that will need to be considered at another time.

Our time has come to an end. We thank you for your attention.

> (a) If the Closing occurs, Seller and Shareholders will have liability (for indemnification or otherwise) with respect to any Breach of (i) a covenant or obligation to be performed or complied with prior to the Closing Date (other than those in Sections 2.1 and 2.4(b) and Articles 10 and 12, as to which a claim may be made at any time) or (ii) a representation or warranty (other than those in Sections 3.9, 3.14, 3.16, 3.22, 3.29, 3.30, 3.31 and 3.32 as to which a claim may be made at any time), but only if on or before ______________, 20__ Buyer notifies Seller or Shareholders of a claim specifying the factual basis of the claim in reasonable detail to the extent then known by Buyer.
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> (b) If the Closing occurs, Buyer will have liability (for indemnification or otherwise) with respect to any Breach of (i) a covenant or obligation to be performed or complied with prior to the Closing Date (other than those in Article 12, as to which a claim may be made at any time) or (ii) a representation or warranty (other than that set forth in Section 4.4, as to which a claim may be made at any time), but only if on or before ______________, 20__ Seller or Shareholders notify Buyer of a claim specifying the factual basis of the claim in reasonable detail to the extent then known by Seller or Shareholders.

Acquisition Agreements, *supra* note 8, at 230-31.

94. In *Ameristar Casinos, Inc. v. Resorts International, Inc.*, No. 3685-VCS, 2010 WL 1875631 (Del. Ch. May 11, 2010), an indemnity cap provision said that it was inapplicable "in the event of fraud or any willful breach of the representation" and plaintiff claimed a willful breach of the tax representation because defendant had received notice of a 248% increase in the ad valorem tax valuation of defendant's principal asset—a casino—which would inevitably lead to a substantial increase in the ad valorem taxes on it, and the court found this was sufficient pleading of both actual fraud and willful breach of representations so as to avoid the indemnity cap for purposes of denial of a motion to dismiss.

95. *See Acquisition Agreement*, *supra* note 8, 267-69.